CCH Audit Automation

Audit Procedures Manual

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A OVERVIEW

1 New in the 2022 release

1.1 ISA 315 was amended in July 2020 and is effective for audits of financial statements for periods beginning on or after 15 December 2021.

1.2 The changes introduced by this amendment have been included in the master packs and this manual. They include the following key items:

a) Greater focus on **professional scepticism** in the advisory material.

b) Increased focus on **information technology**, including the need to understand an entity's use of IT in its business, with new requirements in relation to IT general controls.

c) Requirements in relation to **understanding the entity and its environment** have been expanded and the importance of understanding the applicable financial reporting framework has been elevated.

d) **Five inherent risk factors** (complexity, subjectivity, change, uncertainty and susceptibility to misstatement due to management bias or other fraud risk factors insofar as they affect inherent risk) have been added to assist the auditor in undertaking the risk assessment process.

e) The concept of a '**spectrum of inherent risk**' (previously set out in the December 2018 version of ISA 540) has been introduced into ISA 315. The spectrum is based on the likelihood and magnitude of a possible misstatement, with significant risks at the upper end of this spectrum.

f) A clarification that **control risk and inherent risk** should be considered separately, and that where the auditor does not plan to test the operating effectiveness of controls, the assessment of the risk of material misstatement must be the same as the assessment of inherent risk.

g) A new concept of **significant classes** of transactions, account balances and disclosures has been introduced to assist with the identification and assessment of the risks of material misstatement. Significant class of transactions, account balance or disclosure is defined as 'A class of transactions, account balance or disclosure for which there is one or more **relevant assertions**.' Note that 'relevant' in this context is defined as follows: 'An assertion about a class of transactions, account balance or disclosure is relevant when it has an identified risk of material misstatement. The determination of whether an assertion is a relevant assertion is made before consideration of any related controls.'

h) **Stand-back requirements** have been introduced, requiring auditors to review all material classes of transactions, account balances or disclosures that have not been determined as significant. Similarly, auditors are required to consider whether the audit evidence obtained from the risk assessment procedures provides an appropriate basis for the identification and assessment of the risks of material misstatement. If not, auditors must perform additional risk assessment procedures until audit evidence has been obtained to provide such a basis.

2 Purpose of this manual

2.1 When carrying out an audit (or any other professional engagement), the firm's four main objectives should be:

a) To provide the client with a professional service of the highest quality,

b) To carry out work to the highest professional standard,

c) To provide a cost-effective client service, and

d) To offer staff every opportunity to develop their professional career by giving of their best as a highly motivated member of the team, and having their contribution recognised.

2.2 The ISAs (UK & Ireland) contain useful guidance and this Manual does not aim to reproduce their content. Where appropriate, a reference is made to them.

2.3 This manual does not replace the firm's own procedures and should be used only as a resource for producing or revising the firm's procedures. Where the manual is adopted in whole or in part, it is the responsibility of the firm to ensure that the manual is modified to meet the firm's specific circumstances and to ensure that any changes to legislation or regulations are applied between updates to this manual.

3 Statutory audits

3.1 The objective of an audit is to enable the auditor to express an opinion whether the financial statements are prepared, in all material respects, in accordance with applicable UK or International Financial Reporting Standards and relevant law.

3.2 The financial statements will normally consist of:

a) Director's report

b) Audit report

c) Profit and Loss Account/Statement of Comprehensive Income

d) Statement of Changes in Equity

e) Balance Sheet/Statement of Financial Position

f) Statement of Cash Flows

g) Notes to the Accounts

3.3 The audit opinion covers c) to g) above. The responsibility in relation to the Director's report is limited to ensuring it:

i) is consistent with c) to g) above;

ii) does not contain any apparent misstatements

3.4 An unqualified audit report also refers to the following (per S498 Companies Act 2006):

a) Accounting records have been properly kept.

b) The accounts are properly prepared in accordance with the underlying records.

c) Proper returns have been received from branches not visited by us.

d) We have received all information and explanations we deem necessary for the purposes of the audit.

e) Where applicable, the company is entitled to the exemption from small groups preparing group accounts.

3.5 There are many other types of enterprise which are also required either by law, by their constitution or by the regulations of a governing body, to prepare and have independently audited annual accounts. Examples of such enterprises are Friendly Societies, Housing Associations, certain charities, etc.

4 Non-statutory audits

4.1 Where an audit report is given on the accounts of unincorporated organisations, (eg partnerships) the same audit standards should apply, subject to any agreement made with the client limiting the scope of work performed.

5 The use of Audit Automation

5.1 The Audit Automation documentation has been designed to be flexible and provide a framework which can be tailored to suit the specific circumstances of the client whilst ensuring compliance with Auditing Standards.

5.2 The pack should be tailored to suit the specific circumstances of the client to ensure that the work is properly focused and is carried out as cost-effectively as possible. Any tailoring carried out in Audit Automation is carried forward from year to year and **must** be reviewed for each assignment.

5.3 The Audit Automation methodology is designed to enable the firm to focus its audit effort on those financial statement areas and audit assertions where there are significant risks of material misstatement. This will enable the firm to:

a) satisfy the overall audit objective of 'providing reasonable assurance that the financial statements taken as a whole are free from material misstatement' as efficiently as possible;

b) maximise the value to clients of the audit service provided by:

   i) ensuring the service is provided in as hassle-free a manner as possible.

   ii) providing sound, constructive advice to help clients solve the business problems they are facing.

5.4 The audit approach places a high emphasis on planning, thereby ensuring that the firm carries out the audit as efficiently and effectively as possible. More time spent on planning will generally reduce the fieldwork to the minimum necessary as well as streamline audit completion (which is where most cost overruns occur).

6 Audit exempt entities

6.1 For companies exempt from audit, a non-audit master pack and a limited assurance pack is provided within Audit Automation to allow for the production of an accounts preparation file and disclosure checklists for non-audit clients.

B AUDIT APPROACH

1 Overview

1.1 The audit approach involves the following stages:

Pre-audit planning

- Review terms of engagement
- Identify any changes to the business, its environment and its accounting and management information systems
- Briefing meeting

Planning

- Review information obtained from our experience with the entity and from audit procedures performed in previous audits
- Gather/review information that enables us to understand of the business and its accounting and management information systems
- Review our understanding of the applicable financial reporting framework
- Determine financial statement areas
- Perform preliminary analytical review
- Consider whether there are likely to be going concern problems
- Determine materiality and performance materiality, and the threshold above which misstatements cannot be regarded as clearly trivial to the company.
- identify the risks of material misstatement at the financial statement level and the assertion level for classes of transactions, account balances and disclosures
- Determine if any of the identified risks constitute significant risks
- For identified risks of material misstatement at the financial statement level, design overall responses
- For identified risks of material misstatement at the assertion level, design appropriate audit procedures
- Where appropriate, design tests of control
- Hold discussion between audit team of the risks identified and the susceptibility of the entity to fraud
- Prepare Audit Planning Memorandum and Audit Programmes
- Communicate audit plan to client

Execution of the audit

- Perform and evaluate planned audit procedures (modified if necessary)
- Consider issue of interim bill to cover costs to date

Completion procedures
Completion procedures ▪ Reviews of work done ▪ Evaluate overall results of audit procedures ▪ Summary of unadjusted errors ▪ Overall Review of Financial Statements ▪ Subsequent Events Review and Going Concern Review ▪ Letters of Representation
Reporting ▪ Issue audit report ▪ Issue Report to Management
Closing the audit ▪ Issue final bill ▪ Review audit efficiency

1.2 Some organisations have a less well-defined accounting system. However, the audit requirements are the same for these 'small audits' and will be met by tailoring the audit pack.

1.3 The Group Pack is applicable both where the firm audits all members of the group, and where there are component auditors involved. It includes planning and reviewing the work of such auditors and their working papers.

1.4 The Group Packs do not cover the audit of the parent company itself and hence will be supplemented with a separate pack for the audit of the parent company.

2 Knowledge of the business

Audit Automation provides a means of recording the firm's accumulated knowledge of the business in a manner which can be referred to both during the planning and conduct of the audit. Predefined routines are provided for the recording of the following and are stored in the current audit file:

- **Preliminary analytical review** - evaluation and recording;
- **Background knowledge** – this is recorded in a combination of brief internal notes and associated word processing or spread sheet templates;
- **Key business processes** – allowing the recording of business systems using brief notes, process flow records and links to external documentation.
- **Key controls database** – allowing you to record the key controls that are in place, your observations in respect of the effectiveness and implementation of the control and whether or not further testing is to be carried out. If further testing is to be carried out, procedures can be recorded in respect of the test and a conclusion can be entered on the results thereof.

There is also the facility to record a permanent file, which provides for the following:

Standing data	Key information such as date of incorporation.

Addresses	Records are provided for key address information, such as locations, bankers, solicitors etc. With each address, contact information can be stored together with any relevant notes.
Shareholders	Any number of shareholders may be recorded. Fields are provided for contact information, shares held and movements and notes.
Directors	As shareholders.
Key staff	As shareholders.
Other contacts	As shareholders.
General file	Allowing the creation of document based in templates, free format and scanned documents.

In addition the planning memo is carried forward from year to year and may also contain relevant notes regarding the business.

3 Documenting the audit

3.1 ISA (UK & Ireland) 230 ‘Audit Documentation’ and 500 ‘Audit Evidence’ require us to document in our working papers the matters which are important in supporting our opinion. Working papers are the record of:

a) the planning and performance of the audit;

b) the supervision and review of the audit work; and

c) the audit evidence resulting from the work performed to support our opinion on the financial statements.

3.2 It is important that all work done is documented thoroughly. If work is referred to as having been completed but is not documented, a court or reviewer would likely assume that the work had not been done and that (therefore) we had insufficient evidence to support our opinion.

3.3 For convenience, our work is contained in the following files, all of which are required for each audit assignment:

a) Permanent Audit File

b) Current Audit File

c) Signed Accounts File

3.4 Audit Automation provides facilities to document our work and review it on screen and this should be used wherever possible to do this. However, where this is not practicable, the audit should be planned on Audit Automation and printed after the planning has been signed off. The printed documents can then be completed manually.

Permanent audit file

3.5 The Permanent File should contain matters of a permanent nature and hence ofcontinuing importance to the affairs of that client. It should be sufficiently complete to enable a new audit team member to glean sufficient background information to enable him to carry out the work allocated to him. It should therefore contain at least the following, or identify where the information is to be found:

a) our documentation to support the verification of identity of the client;

b) current letters of engagement;

c) copies of the Memorandum and Articles of Association with other key documents and agreements (preferably with abstracts of key terms etc).

d) our documentation of our knowledge of the business. ISA 315 ‘Identifying and Assessing the Risks of Material Misstatement Through Understanding of the Entity and Its Environment ‘ gives guidance on the matters we should consider in this respect. This documentation should support our assessment of inherent risk.

e) our documentation of the clients accounting, management information and information control systems. ISA 315 gives guidance on this. This documentation should support, where appropriate, our assessment of the Control Environment.

3.6 The systems can be documented using flowcharts or narrative notes and should cover:

a) documentary and information flows which result in posting to the nominal ledger (note that we are not interested in what happens to every copy of every document).

b) documentary and information flows which result in reports used by management to monitor and control the business.

c) controls (both manual and computer-based) which ensure the completeness, validity and accuracy of the above documentary and information flows.

3.7 The information in the file should be up-to-date and relevant. Any superseded information or information of no further relevance should be transferred to Section Z of the Current Audit file.

3.8 There is a Permanent File section within Audit Automation and the majority of the above can be recorded within the system and carried forward from year to year. Where appropriate, you can also scan documents to record in this electronic file.

Current audit file

3.9 A good current audit file:

a) enables an economic but detailed review to be undertaken;

b) records the evidence obtained to support our audit opinion;

c) contains evidence of the work we have done and the conclusions we have drawn therefrom.

3.10 It is impossible to specify what schedules should be kept on the current audit file, but the standard index should be helpful as a guide. The number should be kept to the essential minimum and thus before any schedule is prepared, we should consider:

a) what is its purpose?

b) will it provide support to our audit opinion or enable us to offer constructive advice to our clients?

c) is the information to be shown available elsewhere in the file?

3.11 The fact that it was prepared in the previous year is not, in itself, a sufficiently good reason for its preparation this year. We must also avoid the temptation to expand the file with extensive photocopies or scanning of entries in the client's books and of original documents (unless they will be useful to support the tax computations).

3.12 To save unnecessary time, we should make enquiries to see whether any particular schedules that we may require are already being prepared by our client albeit for a non-accounts purpose. Very often, clients who do not at present prepare schedules can be persuaded to do so in the interests of minimising costs.

3.13 Each composite figure appearing in the balance sheet must be supported by a lead schedule breaking down the figure under appropriate headings, into the component parts.

3.14 If any of the lead schedule headings are themselves composite figures, supporting schedules will be necessary.

3.15 In compiling the file, we should see that:

a) each schedule prepared by us is correctly headed; giving the client’s name, the period to which the accounts relate, the date of preparation and the initials of both the preparer and the reviewer;

b) each schedule prepared by the client shows the date upon which we received it in addition to the relevant parts of (a);

c) insofar as it is not clear from the programme, particulars of the work carried out are noted;

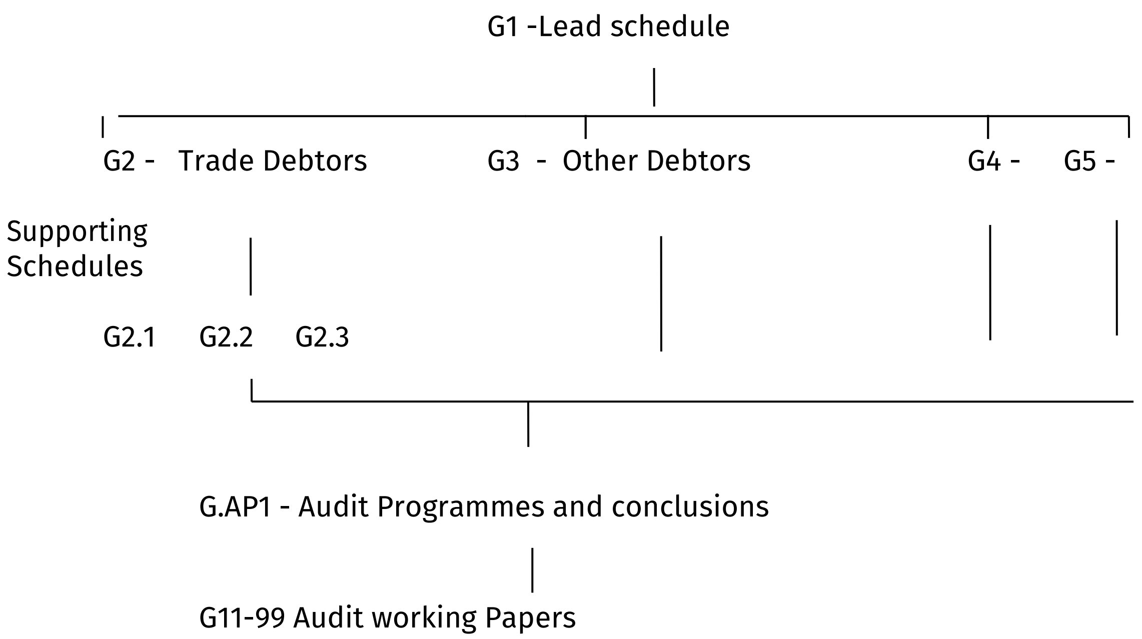
d) where audit ticks have been used, a key to their meanings has been shown.

3.16 It is fundamental that lead schedule totals are in agreement with the figures in the balance sheet and that schedules supporting tests we have undertaken clearly show the conclusion drawn and reasons for so doing.

3.17 Where Audit Automation is used to create working papers, you can base these on templates and the system will automate the inclusion of the required static information.

Indexing and referencing working papers

3.18 Our referencing system operates in accordance with the following example:



Notes

a) The accounts are referenced to the lead schedules.

b) Lead schedules are cross referenced to lead schedules and referenced to backing schedules.

c) Support schedules are cross referenced to lead schedules and referenced to backing schedules.

d) Backing/detail schedules are cross referenced to support schedules.

e) Support schedules and backing schedules should be referenced in a ‘pyramid’ form to the main support schedule.

f) If it is necessary to continue a schedule onto a second or more sheet, the schedule number will remain the same but each sheet should be additionally numbered 1 of 3, 2 of 3 etc.

4 Appointment and terms of engagement

4.1 Before accepting an appointment, we need to follow the Acceptance Procedures, verify the client's identity and consider:

a) whether the client is reputable and someone we are happy to be associated with

b) whether there are any ethical reasons why we cannot act

c) whether we are competent to act, ie we have the necessary expertise, degree of independence and qualifications, and can service the client's needs and deadlines

d) whether the potential client can pay our fees and is likely to do so.

e) whether there any imposed limitations on the scope of our work

4.2 The **Reappointment Acceptance Checklist** documents this.

4.3 After acceptance we need to send an Engagement Letter.

4.4 We need to reconsider client retention annually and document our decision. This decision is documented at the end of the audit as part of the **Partner Review Checklist** (Sch A-Cl.1) and before planning commences by the **Reappointment Acceptance Checklist** (Schedule B-CL2).

4.5 The client's needs with regards to the nature and timing of all reports that may be required then needs to be determined. If any of these requirements are not covered by any existing Letter of Engagement, an appropriate letter needs to be obtained.

4.6 Guidance is given in ISA (UK & Ireland) 210 'Agreeing the Terms of Audit Engagements' and 300 'Planning an Audit of Financial Statements'

5 Initial planning

5.1 It is important to obtain information from the client about any significant changes from previous years. This may be carried out at an interim visit or through formal meetings, telephone conversations, e-mail or letters. over the phone. We should document all discussions with the client's management and, if different, those charged with governance concerning the audit. These discussions should cover, inter alia:

- changes to management, new laws, regulations and accounting standards, outcome of any PAYE or regulatory visits, financial performance and any going concern issues;
- significant changes in the company's trading activities and the environment in which it operates,
- changes to accounting, internal control and management information systems (including fraud risk);
- details of any actual, suspected or alleged fraud
- changes to related parties and existence of transactions not on the ordinary terms of trade, and
- general scope of engagement, and outline timetable.

5.2 We should then assess whether the client due diligence records are up-to-date and adequate, and have been updated for any significant changes in the client's senior management, ownership and structure etc.

5.3 We need to hold a Briefing Meeting between the partner, manager, audit senior and, if appropriate, tax personnel. The length of this meeting will obviously vary depending on the complexity of the audit. The meeting should include at least the following:

a) Review of correspondence, tax and other files for matters that may affect the accounts or the audit and consider points brought forward from last year

b) Pooling knowledge about the client’s affairs

c) Identification of non-audit services that have been supplied to the client during the period by the firm or a network firm, and considering the ethical requirements arising.

d) Considering whether an Engagement Quality Control Review by another Responsible Individual is required.

e) Identification of the scope of our work and responsibilities, extent of special reports, tax work etc.

f) Agreeing outline timetables and staffing.

g) Identifying problems with unpaid fees.

h) Identifying any matters that need to be resolved before carrying out full audit planning.

5.4 The information gathering and the audit planning will be the responsibility of the manager and audit senior, with the partner approving the audit strategy contained in the General Planning Memorandum.

Budgets

5.5 Budgets are important:

a) to improve the financial performance of the firm;

b) to assist in client retention decisions;

c) to assist with performance appraisals of partners, managers and staff.

5.6 The budgets will be prepared by audit area and by personnel based for larger engagements on test-by-test budgeting. Because of their method of production, realistic budgets can be prepared and agreed (ie the budgets are not based on recoverable fees). When the actuals are recorded, variances can be produced and analysed. This analysis will be used to:

a) bill clients for additional work we have had to do because of the inefficiencies (based on the Audit Planning Letter);

b) appraise performance of managers and staff.

c) improve the accuracy of budgeting in future years, thereby assisting with future fee negotiations.

5.7 Facilities are provided within Audit Automation to allow budgets to be recorded on both basis and for variances to be analysed using the time recorded as taken on each audit test.

6 Understanding the client's business

6.1 The auditor's understanding of the entity and its environment, and the applicable financial reporting framework, assists the auditor in understanding the events and conditions that are relevant to the entity, and in identifying how inherent risk factors affect the susceptibility of assertions to misstatement in the preparation of the financial statements, in accordance with the applicable financial reporting framework, and the degree to which they do so. Such information establishes a frame of reference within which the auditor identifies and assesses risks of material misstatement. This frame of reference also assists the auditor in planning the audit and exercising professional judgment and professional scepticism throughout the audit, (ISA 315.A50)

6.2 This process is a key element our identification of risks of material misstatement, as set out in Section 10. At every point, we should be considering the potential risks of material misstatement and should document any information relevant to that.

6.3 This extensive information gathering may involve an interim client visit.

6.4 We use the **Understanding the client's business checklist** to guide our review and documentation of the following:

a) appropriate information about the organisation of the client, its business, and its operating methods, how its management controls the business, and its financial condition (including whether it has potential going concern problems);

b) the laws and regulations applicable to the client's activities and the procedures established by the directors to prevent any non-compliance with such laws and regulations, and detect any that occurs;

c) the accounting system for recording and processing transactions, together with controls over it (see below - the client's system of internal control); and

d) our understanding of the applicable financial reporting framework and the entity's accounting policies.

The client's system of internal control

6.5 ISA 315 defines the system of internal control as:

The system designed, implemented and maintained by those charged with governance, management and other personnel, to provide reasonable assurance about the achievement of an entity's objectives with regard to reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations. (ISA 315.12m)

6.6 For the purposes of the ISAs, the system of internal control consists of five inter-related components:

- Control environment;
- The entity's risk assessment process;
- The entity's process to monitor the system of internal control;
- The information system and communication; and
- Control activities.

All of the above will therefore be documented and assessed as part of our audit, guided by the requirements set out in the **Understanding the client's business checklist.**

Control environment

6.7 ISA 315.21 requires us to ‘obtain an understanding of the control environment relevant to the preparation of the financial statements’. This involves understanding the set of controls, processes and structures that address:

a) How management’s oversight responsibilities are carried out, such as the entity’s culture and management’s commitment to integrity and ethical values;

b) When those charged with governance are separate from management, the independence of, and oversight over the entity’s system of internal control by, those charged with governance;

c) The entity’s assignment of authority and responsibility;

d) How the entity attracts, develops, and retains competent individuals; and

e) How the entity holds individuals accountable for their responsibilities in the pursuit of the objectives of the system of internal control;

6.8 Also, ISA 315.21 requires us to evaluate whether

a) Management, with the oversight of those charged with governance, has created and maintained a culture of honesty and ethical behavior;

b) The control environment provides an appropriate foundation for the other components of the entity’s system of internal control considering the nature and complexity of the entity; and

c) Control deficiencies identified in the control environment undermine the other components of the entity’s system of internal control.

Risk assessment processes

6.9 ISA 315.22 requires us to obtain an understanding of the entity’s approach to identifying and assessing business risks relevant to financial reporting objectives, and to evaluate whether the entity’s risk assessment process is appropriate to its circumstances.

Monitoring the system of internal control

6.10 ISA 315.24 requires us to obtain an understanding of the entity’s process for monitoring the system of internal control relevant to the preparation of the financial statements, and to evaluate whether the entity’s process is appropriate to its circumstances.

Information system and communication

6.11 ISA 315.25 requires us to obtain an understanding of the entity’s information system and communication relevant to the preparation of the financial statements, and to evaluate whether the entity’s process is appropriate to its circumstances, including:

a) How information flows through the entity's information system, including how

   i) Transactions are initiated, and how information about them is recorded, processed, corrected as necessary, incorporated in the general ledger and reported in the financial statements; and

   ii) Information about events and conditions, other than transactions, is captured, processed and disclosed in the financial statements;

b) The accounting records, specific accounts in the financial statements and other supporting records relating to the flows of information in the information system;

c) The financial reporting process used to prepare the entity#s financial statements, including disclosures;

d) The entity's resources, including the IT environment, relevant to the above;

e) Understanding how the entity communicates significant matters that support the preparation of the financial statements and related reporting responsibilities in the information system and other components of the system of internal control

6.12 Our understanding of the accounting system needs to cover the accounting systems for all major transaction streams. Since we are primarily concerned with what is posted to the nominal ledger, we need to focus on documentary and information flows which result in postings to the nominal ledger, together with the controls over their completeness, validity and accuracy.

- For most clients, this will normally be a textual description of the accounting systems contained in the Permanent File section.
- For more complex clients, flowcharting may be more appropriate. If we are flowcharting the accounting system, it is more efficient if the flowchart begins with the nominal ledger and follows the system backwards to the boundary. This method of flowcharting is simple and quick to use and will ignore extraneous detail; and

6.13 Since nearly all clients are at least partly computerised, we will need to review and understand their computer processing. In many cases this will not be difficult since they use off-the-shelf unmodified packages. For all clients, we will need to document the structure and complexity of the entity’s IT environment and the reliance upon IT in relevant aspects of business operations and financial reporting.

6.14 ISA 315 requires the auditor to review the IT system to identify any indications of increased risks of material misstatement. The **General IT risks checklist** (based upon ISA 315 Appx 5 and 6) assists the user to accomplish this. This is an optional checklist because some users will have their own documentation they prefer to rely upon. However, this or an equivalent approach must be used.

Evaluation of the system of internal control

6.15 After documenting the above, we use the **Control Strengths Checklist** to help us form an overall evaluation of the strength of the supervisory procedures and information systems.

6.16 We also record an overall assessment of the control environment using the **Control Environment Questionnaire**.

6.17 Both of these are provided to help us with our evaluations by asking key questions. They are not intended to provide a formal audit conclusion.

Control activities

6.18 ISA 315.26 also requires us to obtain an understanding of the control activities component.

6.19 Note that this is a requirement only for (ISA 315.26):

a) Controls that address a risk that is determined to be a significant risk;

b) Controls over journal entries, including nonstandard journal entries used to record nonrecurring, unusual transactions or adjustments;

c) Controls for which we plan to test operating effectiveness in determining the nature, timing and extent of substantive testing, including controls that address risks for which substantive procedures alone do not provide sufficient appropriate audit evidence; and

d) Other controls we consider are appropriate to enable us to meet the objectives of paragraph 13 (obtaining audit evidence that provides an appropriate basis for the identification and assessment of risks of material misstatement) with respect to risks at the assertion level.

e) General IT controls that address risks related to items above.

6.20 For the above, we use the **Controls Evaluation Checklist** to:

a) record the systems and controls that are in place

b) review the design of the internal control system and ensure they are adequate to the size and nature of the entity

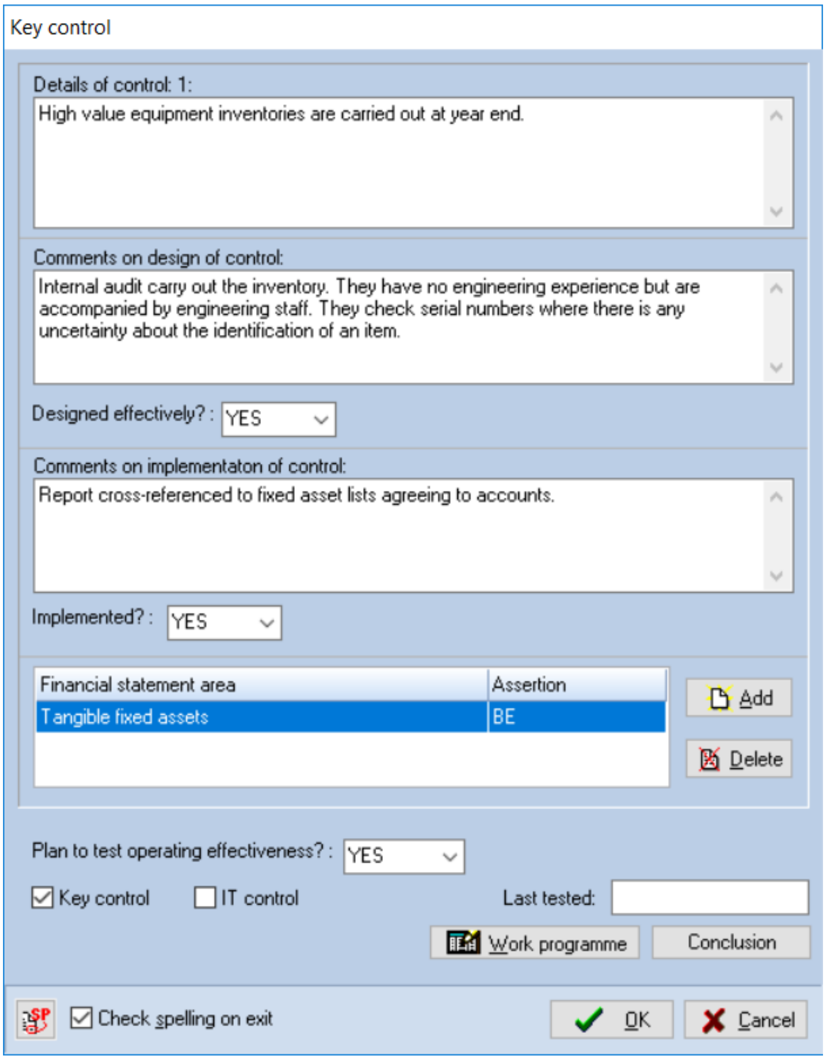
c) consider the possibility of management override

d) determine whether the systems operate in the way recorded, by observation of the operation of the controls and enquiry of management, together with walkthroughs.

e) if weaknesses are identified, ensure they are reported to management.

6.21 Note that we do NOT need to record the control activities for all parts of the accounting system - only for those items set out above in 5.19.

6.22 The best way to record these key controls is by using the key controls screen (see section 11.39). Note that the dropdown “Plan to test operating effectiveness?” would be set to “no” or “n/a” unless we were planning to test the controls as part of our audit evidence.



6.23 Based on control activities identified above, we also need to identify the IT applications and the other aspects of the entity's IT environment that are subject to risks arising from the use of IT and then identifying (ISA 315.26c,d):

a) The related risks arising from the use of IT; and

b) The entity's general IT controls that address such risks.

6.24 We need to confirm our understanding of the key elements of accounting systems and any relevant controls over them by performing walkthrough procedures. Generally, the walkthroughs should test at least three items per transaction stream which, together with observation and enquiry procedures, should ensure our understanding of the systems are correct.

The financial reporting framework and the entity's accounting policies

6.25 It is assumed that the auditor will have a clear understanding of the financial reporting framework (eg FRS 102 + Companies Act requirements). However, there may be recent changes to this framework that should be reviewed, documenting their effect on the entity's financial reporting.

6.26 Similarly, there may be changes to the entity's business that require a reassessment of the disclosures to be made.

6.27 We should document any non-standard or complex matters such as:

a) Industry-specific transactions, account balances and related disclosures

b) Unusual or complex revenue recognition

c) Accounting for financial instruments

d) Foreign currency assets, liabilities and transactions.

6.28 Where relevant we should document with regard to the entity's accounting policies:

a) Changes proposed

b) The methods the entity uses to recognize, measure, present and disclose significant and unusual transactions

c) The effect of significant accounting policies in controversial or emerging areas for which there is a lack of authoritative guidance or consensus

d) Changes to the applicable financial reporting framework or tax reforms that may necessitate a change in the entity's accounting policies.

e) Financial reporting standards and laws and regulations that are new to the entity and when and how the entity will adopt, or comply with, such requirements.

General inherent risk assessment - used for guidance only

6.29 Audit Automation contains a list of General Inherent Risk questions. Each question is given a point score which can vary from 0 where an answer is positive (which indicates that no risk arises) to 6 where a negative answer indicates a high risk arises. The system totals the point score and uses the following look up table to determine the overall level of risk:

Risk level	Points <=	Audit risk
3	8	Low
2	15	Medium
1	No limit	High

6.30 General Inherent Risk levels are calculated for general guidance only and do not form part of the sample size calculation.

7 Financial statement areas and their assertions

7.1 The financial statement areas are the building blocks of the audit, and we plan and carry out our audit procedures at this level. We need to use our understanding of the client to determine the financial statement areas before we commence the audit planning. If this is done correctly, the audit will be more efficient.

7.2 Whilst the financial statement areas will generally correspond to the balance sheet and profit and loss account headings, this will not always be the case. Financial Statement Areas are areas on which we will perform audit work appropriate to the area. For example, if sales comprise two separate transaction streams (which are separately identified in the accounting records) requiring different audit procedures, it may be more appropriate and efficient to identify these as two separate 'areas' within Audit Automation. Each area would then include the appropriate tests for its transaction stream in the audit programme, using the tailoring facilities.

7.3 Audit Automation automatically identifies the basic Financial Statement areas from the contents of the Trial Balance and will exclude areas that are not relevant to the client. This can be overridden by entries in Tailoring Questions and the Audit Area section, to include areas not represented in the trial balance.

7.4 The financial statements on which we can express an opinion are presented by management on the basis that they fairly present the income and expenditure for the period and the assets and liabilities at the end of it.

7.5 This general assertion about the financial statements can also be understood as a collection of assertions in relation to each asset and liability, and to each revenue and expense transaction. The audit assertions used by Audit Automation as follows. They are discussed in more detail in Appendix 1.

Code	Description
Account balances	
BC	Completeness
BE	Existence rights and obligations
BV	Valuation and classification
Transactions	
TA	Accuracy and classification
TC	Cut-off
TO	Occurrence
TP	Completeness
Presentation and disclosure	
PD	All assertions

7.6 There is also a 'dummy' assertion ZZ used for identifying risks that are pervasive to the financial statements as a whole.

7.7 Note that some of the assertions in ISA 315 have been combined in our methodology because the assertions will in practice be looked at together:

- *Balances - existence* and *Balances - rights* and obligations are two parts of the same analysis: ‘Does this balance shown in the financial statements relate to assets or liabilities that belong to the entity?’

- *Balances - accuracy, valuation and allocation* and *Balances - classification* are two parts of the same analysis and they are tested at the same time: ‘Was the correct amount included in the correct account?’

- *Transactions - accuracy* and *Transactions - classification* are two parts of the same analysis and they are tested at the same time: ‘Was the correct amount included in the correct account?’

Manual override of audit areas

7.8 When the system initializes the audit programmes and checklists, it makes a number of decisions to customise the pack and produce only those tests that are relevant. The process uses the following automated logic:

a) Top level: For each audit area, do the nominal accounts relating to this area contain any figures, or is there any other trigger set for the section? If not, omit the section completely.

b) Second level: For each audit program and checklist, do the nominal accounts relating to items contain any figures? If not omit the test, question or section concerning these items.

c) Third level: For each audit program and checklist, is the answer to the Tailoring questions relating to the section Y or N? Either include or exclude the tests or question as appropriate.

7.9 There may, however, be occasions when using the figures alone will not produce the desired result. The user can, however, override the system in such cases and this is done using the pop-up menu in the Audit area risk dialog.

8 Performing preliminary analytical review

8.1 Analytical procedures are required as part of planning (ISA 315.14b). The reason for these procedures is set out in the application material:

- A27. Analytical procedures help identify inconsistencies, unusual transactions or events, and amounts, ratios, and trends that indicate matters that may have audit implications. Unusual or unexpected relationships that are identified may assist the auditor in identifying risks of material misstatement, especially risks of material misstatement due to fraud.

- A28. Analytical procedures performed as risk assessment procedures may therefore assist in identifying and assessing the risks of material misstatement by identifying aspects of the entity of which the auditor was unaware or understanding how inherent risk factors, such as change, affect susceptibility of assertions to misstatement.

8.2 The preliminary Analytical Review should be carried out at a fairly early stage of planning and **at a high level**. The work should cover:

a) a comparison of actual results to budget (where the client has sound budgetary procedures) and to the previous year;

b) a comparison of key financial and operating ratios with the previous year's and with each other. We should use as far as possible the key figures and relationships used by management to control their business rather than general financial ratios, and these should be set up in the Equation Editor within Audit Automation.

8.3 The work will usually be performed before draft financial statements have been prepared and hence the procedures may need to be based on interim financial statements or management accounts. For smaller clients this may be restricted to using figures per the VAT returns (adjusted for fixed assets transactions) and discussions with management.

8.4 Before we carry out the Preliminary Analytical Review, we need to make our own predetermined judgement of what we expect to find, based on our understanding of the business, to enable us to draw reasonable conclusions from the review.

9 Determining materiality

9.1 Our audit objective is to obtain reasonable assurance about whether the financial statements show a true and fair view (or are fairly presented, where a true and fair view is not required) and are free from material misstatement.

9.2 Materiality refers to the magnitude or nature of a misstatement that, in the light of surrounding circumstances, makes it probable that the judgement of a reasonable user of the financial statements would have been changed or influenced, as a result of the misstatement.

9.3 Only material misstatements and uncertainties will affect our audit opinion, hence our audit procedures should not be concerned with detecting misstatements that could not be material. They need to be focused towards obtaining assurance that material misstatements do not exist.

9.4 From ISA 320:
10. When establishing the overall audit strategy, the auditor shall determine materiality for the financial statements as a whole. If, in the specific circumstances of the entity, there is one or more particular classes of transactions, account balances or disclosures for which misstatements of lesser amounts than materiality for the financial statements as a whole could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements, the auditor shall also determine the materiality level or levels to be applied to those particular classes of transactions, account balances or disclosures.

11. The auditor shall determine performance materiality for purposes of assessing the risks of material misstatement and determining the nature, timing and extent of further audit procedures.

9.5 Materiality is relevant to:

a) determining when financial statements areas are significant from an audit perspective;

b) determining the extent of our audit procedures, particularly as regards:

   i) the selection of key items (ie items which are individually material)

   ii) the calculation of substantive test sample sizes for interval sampling.

c) evaluating the results of our audit procedures

9.6 Different firms will apply their own model for calculating materiality. In Audit Automation, materiality is calculated based on the information stored in the client's trial balance and the rules which have been defined for the firm. Two materiality figures are calculated, a Base materiality and a Profit and Loss materiality.

a) Profit and Loss materiality is applied to the Profit and Loss areas. However, the Profit and Loss materiality is only used if it is less than the Base materiality; otherwise, the Base figure is applied.

b) Base materiality is applied to the Balance Sheet areas.

9.7 The materiality model provided in Audit Automation is based on averaging the amounts calculated in respect of the following:

Turnover; Gross assets; Result before tax; Net assets/liabilities

Turnover and Gross assets calculation of materiality

If total below	Percentage	Minimum
£500,000	3.0%	
£1,000,000	2.5%	15,000
£2,000,000	2.0%	25,000
£5,000,000	1.5%	40,000
£5,000,000+	1.0%	75,000

Result before tax

5% is used irrespective of the level of profit.

Net assets/liabilities

4% is used irrespective of the level of profit.

9.8 Base materiality is calculated by averaging all of the four items. Profit and loss materiality is calculated by averaging Turnover and Result Before tax.

9.9 If there are any items distorting the figures, eg large bonuses for the directors, then the user may make a manual adjustment to the figures calculated by the system.

9.10 The materiality figures arrived at by the calculations in the pack can be overridden on the materiality screen.

Departures from the calculated materiality

9.11 There may exist some classes of transactions, account balances or disclosures for which smaller changes than general materiality would influence the decisions of the user of the financial statements. Materiality should be set at a different level for these.

9.12 It may also be appropriate to set different Materiality levels for some classes of transactions, account balances or disclosures because of specific circumstances (such as the requirements of a regulatory body).

9.13 A lower Materiality would normally be applied to areas such as related party transactions and directors' remuneration.

Performance materiality

9.14 Performance materiality is the 'working materiality' actually used. It serves two functions:

i) to reduce the aggregation risk (the risk that the aggregate of uncorrected and undetected misstatements individually below materiality will exceed materiality for the financial statements as a whole) to an acceptable level; and

ii) to provide a safety net against the risk of undetected misstatements.

9.15 When calculating sample sizes, performance materiality is used.

9.16 Performance Materiality is often determined as a simple percentage of financial statement materiality, often between 50% to 90%, based on judgement. The default % included within Audit Automation is 50% but this can be overridden in the master pack or on the Materiality screen.

Revision as the audit progresses

9.17 The auditor shall revise materiality for the financial statements as a whole (and, if applicable, the materiality level or levels for particular classes of transactions, account balances or disclosures) in the event of becoming aware of information during the audit that would have caused the auditor to have determined a different amount (or amounts) initially. (ISA 320.12)

9.18 If the auditor concludes that a lower materiality for the financial statements as a whole (and, if applicable, materiality level or levels for particular classes of transactions, account balances or disclosures) than that initially determined is appropriate, the auditor shall determine whether it is necessary to revise performance materiality, and whether the nature, timing and extent of the further audit procedures remain appropriate. (ISA 320.13)

9.19 Guidance for materiality is given in ISA (UK & Ireland) 320 'Materiality in Planning and Performing an Audit'

Group planning materiality

9.20 When planning the audit of Groups, Materiality should be calculated for the Group as a whole and for each component (Component Materiality). Component Materiality should always be less than Group Materiality.

9.21 Group Planning Materiality is calculated using consolidated figures (ie excluding intra-group transactions or balances) for the whole group (ie including subsidiary undertakings for which Group Planning Materiality is not appropriate).

9.22 The levels of Component Materiality should be set out in the Audit Planning Letter, to ensure that the client understands the implications of soothe levels set. If the client wants more work done than we plan to do, it must be borne in mind that this work is not necessary to enable us to form our audit opinion and hence the cost of doing it is additional to our costs for doing the audit.

9.23 Guidance is given in ISA (UK & Ireland) 600 'Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors)

Setting a 'clearly trivial' level

9.24 ISA 450.5 requires auditors to accumulate misstatements identified during the audit other than those that are clearly trivial and do not need to be accumulated because the auditor expects that the accumulation of such amounts clearly would not have a material effect on the financial statements.

9.25 In determining the amount of this threshold, auditors use professional judgement, taking into account their experience of the entity including, for example, the past history of misstatements detected during the audit and their assessment of audit risk.

9.26 In practice, auditors generally consider an amount based on a range of up to 5% of overall materiality to be appropriate, and this is the figure applied within Audit Automation.

10 Determining areas of audit significance

10.1 A significant financial statement area for audit purposes is one in which a material misstatement could arise.

10.2 By definition, any area with a value greater than Performance Materiality is significant.

10.3 Any area with a value less than Performance Materiality might not be significant. If we determine that an area is not significant, **no further work need be done on it**.

10.4 An area less than Performance Materiality may still be significant if:

a) We are not satisfied that it is materially complete. We can generally satisfy ourselves that an area is materially complete from our Preliminary Analytical Review work and a check that there are no obvious omissions - we would not often expect to find nil creditors, for instance.

b) There are reasons, notwithstanding the materiality of the area, why we need to carry out work. Such areas generally include:

- Director's remuneration
- Dividends
- Share capital
- Bank balances
- Stocktake attendance
- Tax balances.

c) There are specific risks. For example, an area will be significant, notwithstanding its size, if a regulator is interested in it.

10.5 Obviously, careful judgement needs to be brought to bear in deciding whether an area is insignificant. In addition, if a number of areas are considered insignificant, we need to be satisfied that in aggregate they remain insignificant.

10.6 Our analyses and judgements are documented in the General Planning Memorandum.

11 Identifying and assessing the risks of material misstatement

11.1 ISA 315 'Identifying and Assessing the Risks of Material Misstatement' sets out the approach expected. Paragraph 11 of the standard states the objective:

'The objective of the auditor is to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels thereby providing a basis for designing and implementing responses to the assessed risks of material misstatement.'

Paragraph 7 explains the basis of this assessment:

'The auditor's risk identification and assessment process is iterative and dynamic. The auditor's understanding of the entity and its environment, the applicable financial reporting framework, and the entity's system of internal control are interdependent with concepts within the requirements to identify and assess the risks of material misstatement.'

11.2 In other words, risk assessment is led by and rooted in our understanding of the relevant aspects of the client's business. Risks are not primarily identified and evaluated by reviewing entries in nominal ledgers (though this has a role in our audit), but by understanding the processes that lead to those entries being included in the ledgers.

11.3 Similarly, risk assessment does not mean taking a list of assertions and trying to attach risk scores to them; instead, risks are identified through our understanding of the business and its environment, and those risks are necessarily further analysed as being either at the financial statement level or linked to specific assertions.

11.4 In other words, our initial direction of approach does not start at the assertion ('What is the risk that the Existence of tangible fixed assets is materially misstated, and by what process does the risk arise?') but instead starts with our understanding of the process by which fixed assets are recorded and reconciled ('Are there risks of material misstatement created by this process, and what assertions do they impact?')

11.5 However, it is important to ensure there is adequate coverage of all assertions and this should be built into the audit in two ways:

a) Within our documentation of our understanding of the business, we should be recording for every group of balances and transactions how the various assertions are met. Using the example above, our documentation regarding tangible fixed assets should include a section concerning how the business ensures that the fixed assets in its ledger are still in existence and belong to the business.

b) When reviewing the planned audit programmes and the area risk assessments, we should be carrying out a series of 'stand-back' procedures. IE, we would ask ourselves, for each material group of transactions and balances, whether we have correctly assessed the risks of material misstatements at assertion level. Using the example above, when reviewing the tangible fixed assets audit area and programmes, we would consider whether the assertion of the existence of material classes of fixed assets has been fully addressed.

Understanding the client's business

11.6 In order to assess the risk of material misstatement and the risk of fraud, we need to carry out a range of procedures each year, documenting both the relevant information and our assessment of any risks that arise.

11.7 **The Understanding the client's business checklist** can be used to guide the process of updating and reflecting upon the understanding obtained. Key elements of this are set out in Section 5.

Preliminary analytical review

11.8 Key elements of this are set out in Section 6.

Risk at financial statement and assertion levels

11.9 ISA 315 requires the auditor to identify risks of material misstatement at:

a) the financial statement level; and

b) the assertion level for classes of transactions, account balances and disclosures.

11.10 For identified risks of material misstatement at the financial statement level, the auditor will assess the risks and:

a) Determine whether such risks affect the assessment of risks at the assertion level; and

b) Evaluate the nature and extent of their pervasive effect on the financial statements.

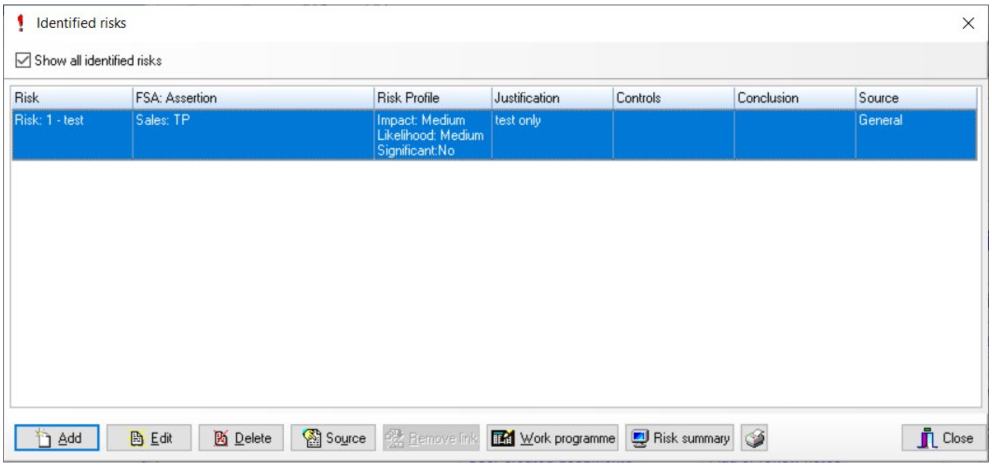
11.11 For identified risks of material misstatement at the assertion level, we will assess inherent risk by assessing the likelihood and magnitude of misstatement and will consider all relevant risk factors (complexity, subjectivity, change, uncertainty and susceptibility to misstatement due to management bias or other fraud risk factors insofar as they affect inherent risk).

11.12 Note that there is no need to assign risk levels for every assertion. Instead, we identify risks through our risk assessment procedures and then consider which assertions are involved.

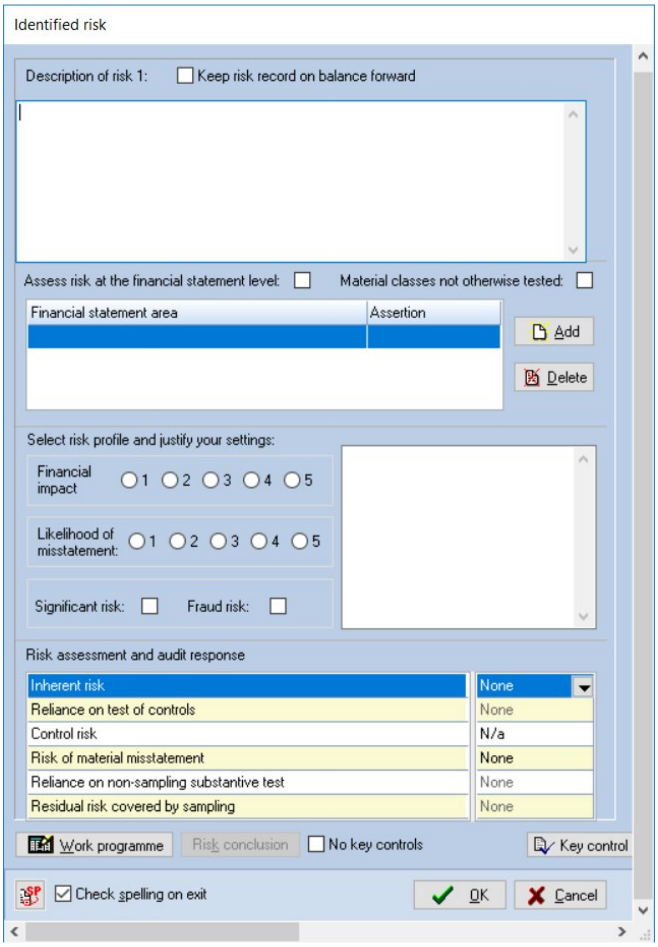
11.13 The recording of these risks is covered in the next section.

12 Recording the risks of material misstatement

12.1 The key entry point for recording risks in Audit Automation is in the Identified Risks screen. There are various ways to call up this screen, such as Planning > Risk analysis > Identified risks.



12.2 Choosing the 'Add' icon takes you through to a screen that allows you to enter the risk and identify its key characteristics:



12.3 Note the various options:

a) Choosing 'Keep risk record on balance forward' will retain this risk so that it appears automatically on the list for next year.

b) Choosing ‘Assess risk at the financial statements level’ will clear the input screens of details relevant only to risks at the assertion level and flag this as a financial statements level risk.

c) Choosing ‘Material classes not otherwise tested’ identifies this as a material class of transactions, account balances or disclosures that has not otherwise been determined have risks of material misstatement. We are required to review these material groupings and confirm our judgement that no risks of material misstatement have been identified.

d) ‘Add’ financial statement area(s) and assertion(s) will take the user to a second screen for identifying the areas/assertions affected by the risk.

e) The ‘Financial impact’ and ‘Likelihood of misstatement’ ratings allow the user to assess the risk according to the requirements of ISA 315.31.

f) Choosing ‘Significant risk’ flags the risk as one that mees the definition of such risks in ISA 315, which will therefore lead to further audit requirements (see ISA 330) and the requirement to identify relevant controls (ISA 315.26).

g) Choosing ‘Fraud risk’ flags the risk as one that mees the definition of such risks in ISA 315, which will therefore lead to further audit requirements (see ISA 240).

h) The ‘Risk assessment and audit response’ allows you to identify your assessment of the inherent risk, whether you expect to place reliance upon controls (and the extent of that reliance), and the reliance to be placed upon non-sampling substantive tests. The residual risk to be covered by sampling is calculated from this information.

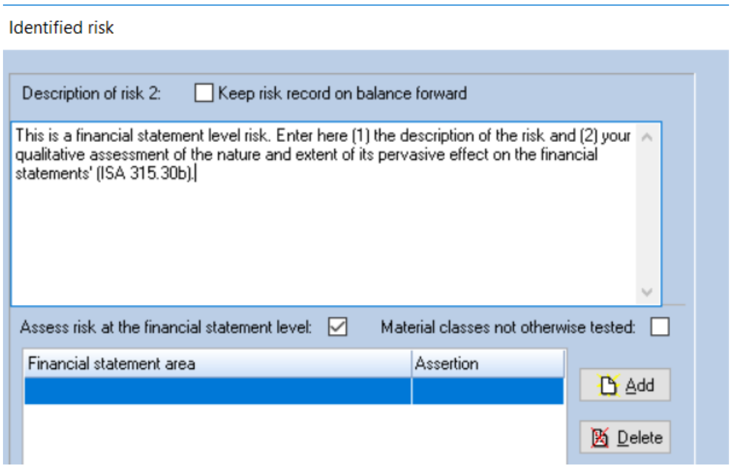
12.4 Choosing ‘No key controls’ states that there are no controls that will be relied upon, and therefore that none need to be recorded for this risk. Note: controls must **always** be identified for ‘significant’ risks, and for controls over journal entries, even if they will not be relied upon.

a) The ‘Key control’ button takes the user to a screen where the key controls can be listed.

b) Choosing ‘Work programme’ takes the user through to a screen where the work programme can be constructed.

Financial statements level risks

12.5 For risks identified at the financial statements level (see picture below):



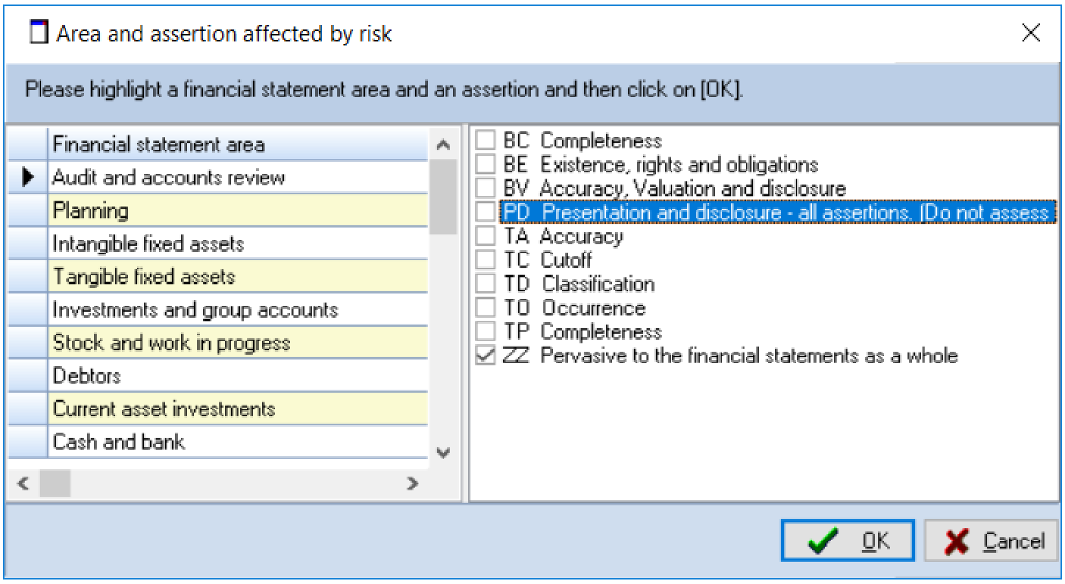
a) These risks are ‘pervasive’ risks. ISA 315 A195: ‘Risks of material misstatement at the financial statement level refer to risks that relate pervasively to the financial statements as a whole, and potentially affect many assertions. Risks of this nature are not necessarily risks identifiable with specific assertions at the class of transactions, account balance or disclosure level (eg, risk of management override of controls). Rather, they represent circumstances that may pervasively increase the risks of material misstatement at the assertion level. The auditor's evaluation of whether risks identified relate pervasively to the financial statements supports the auditor's assessment of the risks of material misstatement at the financial statement level.'

b) The risk is assessed qualitatively only ('Evaluate the nature and extent of their pervasive effect on the financial statements' ISA 315.30b). This information is entered in the same box as the description.

c) The risk is NOT an assertion level risk. However, for the purposes of the software, there are two areas for which a dummy assertion (ZZ) has been created 'Pervasive to the financial statements as a whole'. This 'assertion' is included in the following areas:

   i) A Audit and accounts review (which would include for instance, issues relating to going concern or fraudulent overstatement of the company's position - see ISA 315.A195-A198).

   ii) Y Trial balance and accounts (which would include risks linked to nominal ledger adjustments).



d) Note that either of these two financial areas can be used; two are provided to give the user the option of specifically considering risks that arise in the adjustment processes applied to the underlying nominal postings.

e) The screen below shows this 'assertion' being chosen. Note that in Master packs issued before November 2022, the ZZ assertion will not be included. In earlier packs, the PD assertion can be chosen instead.

f) The user does NOT devise specific tests linked to individual audit assertions as a result. Instead, the user identifies 'overall procedures' in response to the risk (ISA 330.5). Note the explanation of this in the advisory material:

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

• Emphasizing to the audit team the need to maintain professional scepticism.

• Assigning more experienced staff or those with special skills or using experts.

• Providing more supervision.

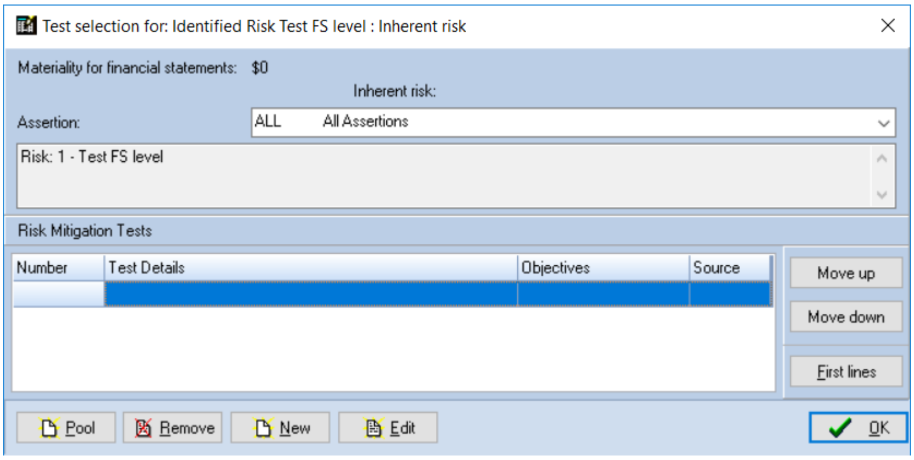
• Incorporating additional elements of unpredictability in the selection of further audit procedures to be performed.

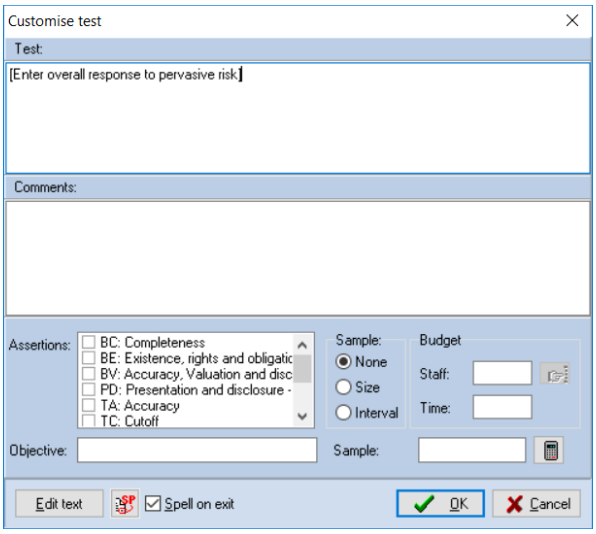
• Making general changes to the nature, timing, or extent of audit procedures, for example: performing substantive procedures at the period end instead of at an interim date; or modifying the nature of audit procedures to obtain more persuasive audit evidence.' (ISA 330.A1)

g) The 'Risk assessment and audit response' section at the bottom of the screen is not completed and the inherent risk is left as 'none' since inherent risk is not assessed for financial statement level risks.

h) Key controls are not relevant to this type of risk.

i) The 'Overall responses' are entered by opening the Work Programme at the bottom of the screen and choosing 'New' so as to enter the audit response (see below).





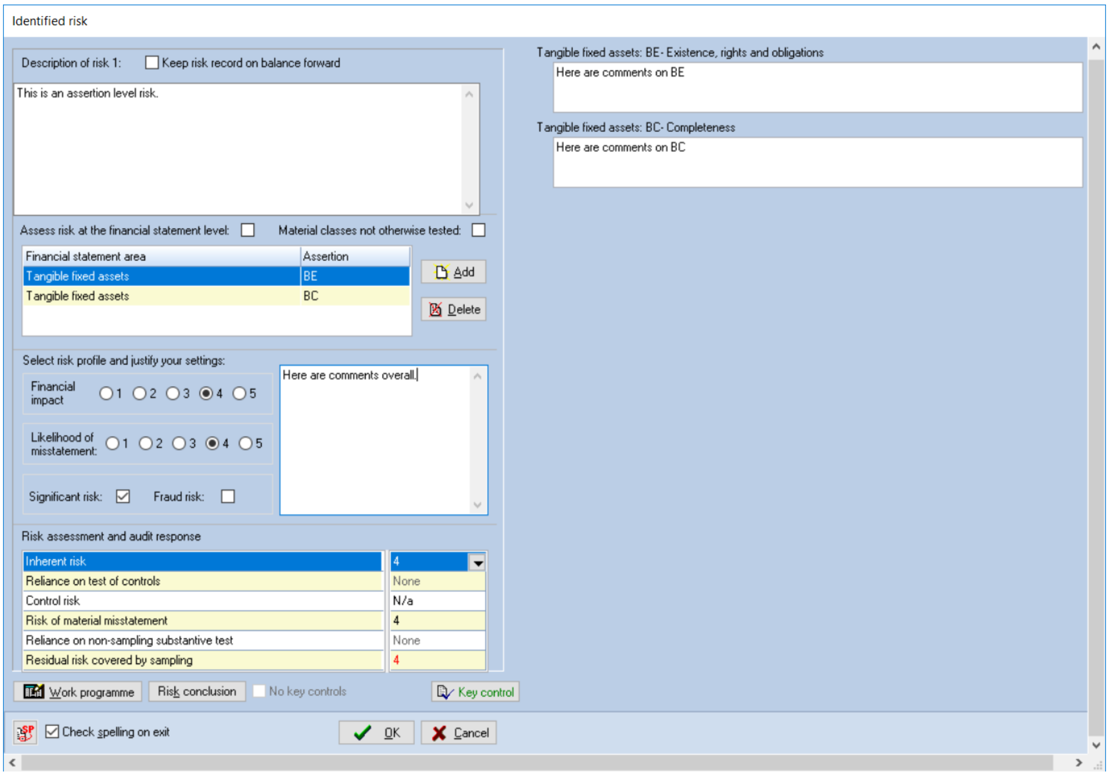
j) The auditor is also required to consider whether there are specific assertions affected by the pervasive financial statements risk. If so, these should be entered separately in the same way as other risks at the assertion level (as set out below). ISA 315.A195: 'In other cases, a number of assertions may also be identified as susceptible to the risk, and may therefore affect the auditor's risk identification and assessment of risks of material misstatement at the assertion level.'

Assertion level risks

12.6 For risks at the assertion level, ISA 315 requires users to consider:

a) Five inherent risk factors (complexity, subjectivity, change, uncertainty and susceptibility to misstatement due to management bias or other fraud risk factors insofar as they affect inherent risk).

b) The spectrum of inherent risk, based on the likelihood and magnitude of a possible misstatement, with significant risks at the upper end of this spectrum. Both financial impact and likelihood of misstatement are assessed in the software on a scale of 1-5, with 5 being highest.



12.7 In the example above, the description of the risk is entered in the top box.

12.8 Assertions are then added - ie the ones affected materially by the risk (at least one assertion must be entered).

12.9 The risk profile is entered separately **for each assertion**. You need to choose each one in turn and choose scores for both financial impact and likelihood.

12.10 Similarly, the justification is entered for each assertion, in the separate small windows to the right. Note that the judgement should refer to the relevant inherent risk factors (complexity, subjectivity, change, uncertainty and susceptibility to misstatement due to management bias or other fraud risk factors insofar as they affect inherent risk).

12.11 Additional justification comments for the risk overall can be added in the box just to the right of the scores, but these will be saved only if you right-click in the box and choose 'Save justification'.

12.12 The Work Programme link (at the bottom of the screen) can be chosen at any time and the user will be able to choose between existing pool tests and the option to add new ones.

12.13 Where controls are not tested and do not need to be assessed, the 'No key controls' option is ticked. Otherwise, the key controls that will be tested are entered by choosing the Key control button and choosing the control(s) from the existing table or adding a new one. (See below for detail)

12.14 Separately for each assertion once again, the 'Risk assessment and audit response' section at the bottom of the screen is completed. The user:

a) chooses the Inherent Risk level (between none to 5) for the assertion highlighted;

b) chooses the level of Reliance on Tests of Control (high, medium, none - but note that the control risk needs to be 'low' if any reliance is being applied);

c) where reliance upon tests of control has been chosen, the user will also enter the 'Control Risk' (high, medium, low, n/a), which is the auditor's **initial assessment** of the likelihood that the risk of material misstatement will not be reduced by controls. Normally, a high control risk would never be entered since if the risk is high, there is little purpose in testing the controls. Where no reliance is placed upon tests of control, the control risk is marked 'n/a' and it is assumed to be 'high'. **This entry does not affect anything else in the table.**

d) enters the Risk of Material Misstatement, which should be the inherent risk as reduced by a favourable (ie low or medium) control risk. Note that if no reliance is being placed upon controls (and therefore there are no tests of those controls), the risk of material misstatement must be considered to be the same as the inherent risk. **This entry does not affect anything else in the table.**

e) enters the level of Reliance on Non-sampling Substantive Tests which includes reliance on other audit areas (high, medium, low, none).

12.15 The software calculates the residual risk from (a), (b) and (e). This residual risk is used for the calculation of substantive sample sizes.

12.16 There are three possible areas for which a work programme is required: tests of control, non-sampling substantive tests, and residual risk covered by sampling. Where any of those three are not "none", the system will require that you click on that row in the Risk assessment and audit response screen and choose or design tests for it.

Note that the creation of a work programme is required for each separate assertion. Often, work chosen for one assertion will apply also to another.

12.17 Our assessment of risks of material misstatement does not normally include the presentation and disclosure assertions since this is covered by specific mandatory procedures (including completing a disclosure checklist). However, where a significant risk has been identified, including fraud risks, this should be recorded in the identified risks screen.

12.18 If however the user wishes to record the risk and response for the presentation and disclosure assertions, this should be entered as an identified risk of the type 'Material classes not otherwise tested'.

Material classes not otherwise tested

12.19 The 'stand-back' procedures require the auditor to 'Review any material classes of transactions, account balances or disclosures that have not been determined to be significant classes of transactions, account balances or disclosures, and evaluate whether the auditor's determination remains appropriate.' (ISA 315.36)

12.20 Note that the word 'significant' in this context means those items that give rise to a risk of material misstatement.

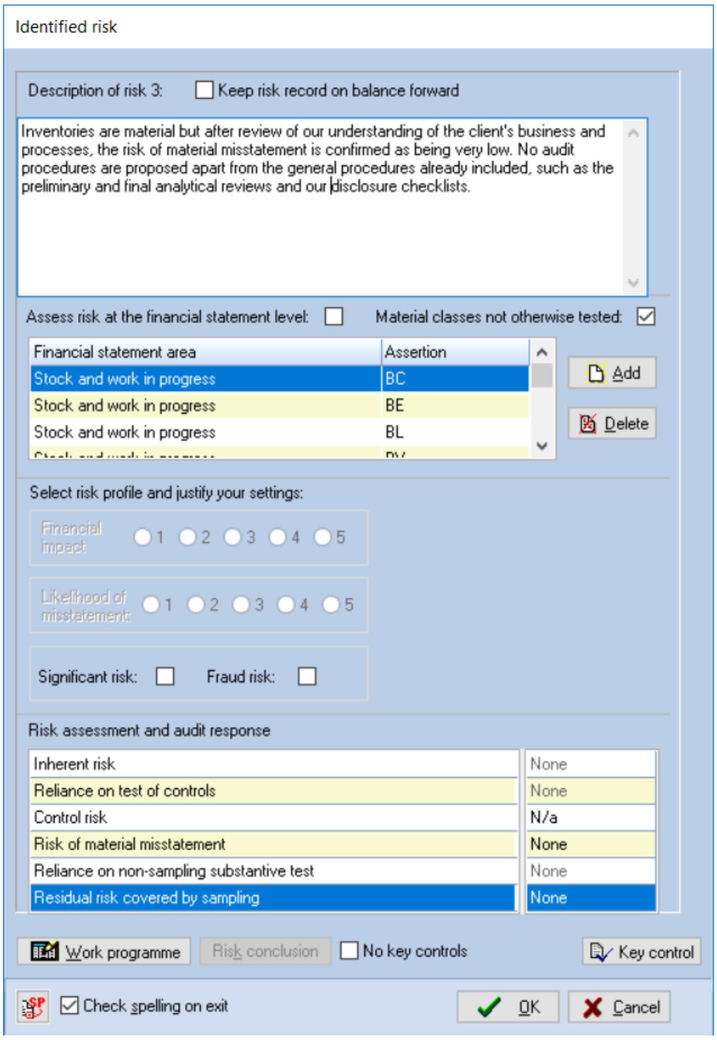
12.21 Since there can rarely be a non-zero risk, when we do not identify a risk of material misstatement, we are not claiming a zero risk, but are assessing instead that the risk is in our opinion so low as to be trivial.

12.22 Even if we choose a risk level of 0, we will be required by ISA 330.18 to carry out some substantive tests: '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.' The substantive procedures can be either substantive analytical review, or tests of detail, or both.

12.23 This review of material classes is covered in two ways in the software. For preference, users should consider these material items by using the Identified risks screen, ticking the box 'Material classes not otherwise tested'.

12.24 A screen such as the one below will be shown. Note the following:

- The appropriate assertions should be chosen
- The risk profile, significant risk and fraud risk are irrelevant since we are confirming that we do not identify a non-trivial risk of material misstatement.
- Inherent risk should be left as 'none'.
- You should tick the box for 'no key controls'.



12.25 Often (as in the example above) we will conclude that our substantive analytical review procedures already provide adequate audit evidence. Where instead we wish to include specific procedures, the work programme link should be used to identify the tests being used.

12.26 An alternative way of dealing with material classes not otherwise tested is to cover them within the Area risk assessment screen (see later).

Inherent risk, Control risk and Reliance upon tests of control

12.27 It is important to understand the relevance of the information entered in the identified risk screens as set out above.

12.28 Inherent risk is 'The susceptibility of an assertion … to a misstatement that could be material … **before consideration of any related controls**.' (ISA 315.4)

12.29 Control risk is 'The risk that a [material] misstatement … will not be prevented, or detected and corrected, on a timely basis by the entity's system of internal control.' (ISA 315.4)

12.30 A given risk of material misstatement might be very high before considering controls, but if there are good controls involved, the resulting risk might instead be very low. (An example of this might be the handling of material cash receipts, which would normally be considered as high risk but can be successfully controlled by various means).

12.31 The figure entered above for 'control risk' is our **initial assessment of how effective the controls will be if they are operating effectively in the way we understand**. ISA 315.A226: 'The auditor's plans to test the operating effectiveness of controls is based on the expectation that controls are operating effectively, and this will form the basis of the auditor's assessment of control risk. The initial expectation of the operating effectiveness of controls is based on the auditor's evaluation of the design, and the determination of implementation, of the identified controls in the control activities component.'

12.32 The assessment of control risk is only explicitly required in the standard for situations where the auditor plans to test the operating effectiveness of controls (ISA 315.34). For risks which are not formally assessed, the risk should be left as n/a or high.

12.33 The assessment of control risk is implied in the standard for (ISA 315.26d):

a) Controls that address a risk that is determined to be a significant risk;

b) Controls over journal entries, including nonstandard journal entries used to record nonrecurring, unusual transactions or adjustments;

c) General IT controls that address risks related to items above or to matters for which the auditor has decided to rely on the controls.

12.34 Note however that the standard stops short of requiring an assessment of control risk. Instead, it requires (ISA 315.26) (1) identifying these controls, (2) evaluating their effectiveness and (3) determining whether they are being implemented. These requirements stop short of formal tests and will be met in the 'Understanding the business' section: see Section 5.19.

Since there is no explicit requirement for assessing control risk in these situations, the software does not require it here and only accepts an assessment of control risk where the auditor intends to perform tests of control.

12.35 Unless a control is tested it cannot be relied upon, and therefore without testing:

- the control risk must be assumed to be high for audit purposes; and
- the risk of material misstatement must be assumed to be the same as the inherent risk (ie, it is not reduced by the benefit of a lower control risk). (ISA 315.34)

12.36 Note that there is normally an inverse relationship between our entries for Reliance on Tests of Control and Control Risk:

a) If control risk is assessed as high, our testing would only confirm that the controls are operating in the way we understand. This would not change our assessment that the controls are highly unlikely to reduce the risk of misstatement.

b) If control risk is assessed as low, then it is likely to be an efficient use of audit time to test the proper operation of the controls to support either a high degree of audit reliance (30 tests per control) or a low degree of reliance (12 tests per control). This will reduce our substantive testing.

c) If control risk is assessed as medium, then although we could test the operation of those controls, this is unlikely to be an efficient use of audit time since we are still left with the assessment that there is a medium risk that the controls will not detect or prevent material misstatement.

12.37 Therefore, the approach adopted in this manual and assumed in the software is:

- **Reliance upon tests of control will not be used unless the control risk is assessed as low.**

ie - If we have judged there is a medium or high risk that the system of internal control will not detect or prevent material misstatements, there is little point in us testing those controls.

12.38 Once we do decide to rely upon controls:

a) we make the initial assessment noted above;

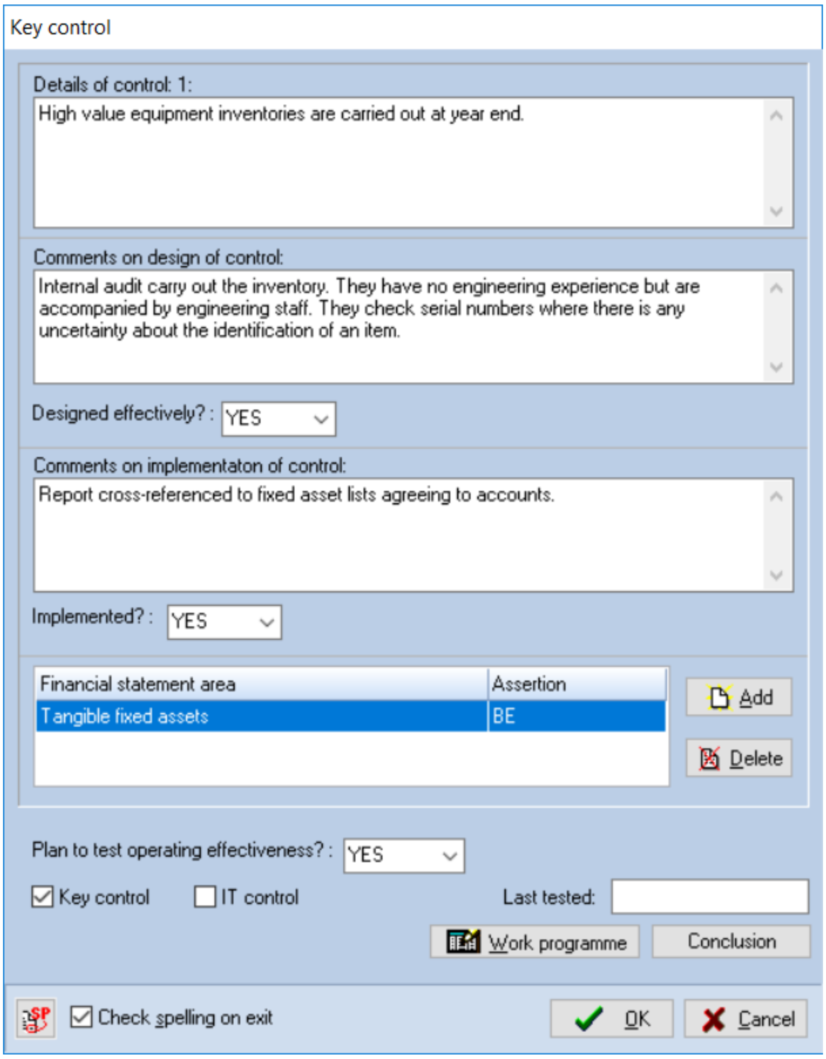
b) we assess the level of reliance we intend to place upon the effect of the controls;

c) if the results of our tests of control lead us to revise our assessment of (a) or (b), we would change those settings for the risk, with a comment explaining why.

12.39 If a control can be shown to be effective, then our assessment of the risk of material misstatement is reduced by the effect of that control. This is reflected in the calculations carried out by the software.

Key controls

12.40 The key controls that will be tested are entered by choosing the Key control button and choosing the control(s) from the existing table or adding a new one, eg:



12.41 Note that this is required only for risks is identified as a significant risk, controls over journal entries, or where tests of control are being carried out.

12.42 For controls that are identified but not tested, the dropdown for “Plan to test operating effectiveness?” can be changed to No or N/A,

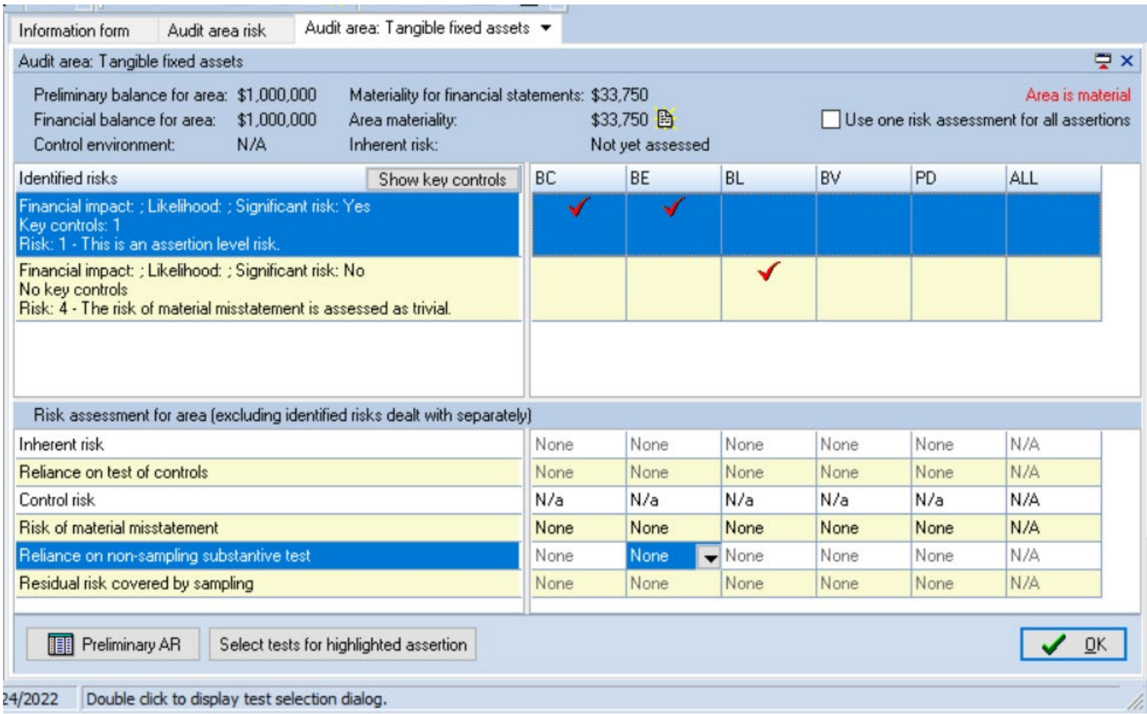
12.43 For significant risks, controls over journal entries, or where tests of control are being carried out, ISA 315.26c,d requires users to identify and assess the related risks arising from the use of IT and the general IT controls that address the risks noted above. Therefore, it is likely that even if the key control itself is not an IT control, there will be an associated IT element which requires evaluation. Note however that these still do not need to be tested unless the controls are being relied upon for audit evidence.

12.44 Using the links at the bottom, the work programme will set out the test and the conclusion will be entered.

Area risk assessment: overall review and stand-back

12.45 After entering identified risks, the user will use the links in the software to the Area Risk Assessment. This enables the user to review the risks for each financial statement area and take the opportunity of overriding the remaining default risk for each assertion, which is set at None.

12.46 The description ‘None’ does not declare that no further risks can possibly exist; instead, it represents our judgement that all non-trivial risks have been already identified.



12.47 The audit area screen will show the risks already identified. The user now has the opportunity to review the audit coverage and decide whether the risk assessment and planned audit responses are complete. This forms part of our stand-back procedures set out below.

Review and stand-back procedures

12.48 We are required to do the following, which should normally be carried out when reviewing the Area risk assessment:

a) (ISA 315.35) Evaluate whether the audit evidence obtained from the risk assessment procedures provides an appropriate basis for the identification and assessment of the risks of material misstatement. If not, perform additional risk assessment procedures until audit evidence has been obtained to provide such a basis. Take into account all audit evidence obtained from the risk assessment procedures, whether corroborative or contradictory to assertions made by management. (Ref: Para. A230-A232)

b) (ISA 315.36) Review any material classes of transactions, account balances or disclosures that have not been determined to be significant classes of transactions, account balances or disclosures, and evaluate whether the auditor's determination remains appropriate. (Ref: Para. A233-A235)

c) (ISA 315.37) If, during the course of the audit, we become aware of new information which is inconsistent with the audit evidence on which we originally based the identification or assessments of the risks of material misstatement, revise the identification or assessment, modify the further planned audit procedures accordingly and document them.

12.49 The user should normally review this screen in conjunction with revisiting our understanding of the client's business, operations and procedures as they relate to each audit area.

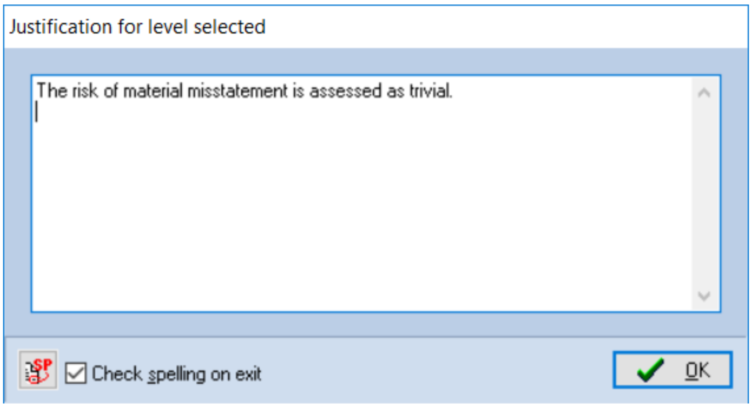
12.50 The user can open the identified risks displayed by double-clicking on them, review and if necessary amend them.

12.51 The user should add further identified risks where appropriate.

12.52 Where there is a material assertion for which no risks of material misstatement have been assessed, the user will see this (eg BV above) and is required to evaluate whether our determination remains appropriate.

a) The preferred way of doing this has been set out above, using the Identified risks screen, ticking the box ‘Material classes not otherwise tested’. This has already been done for assertion BL.

b) Alternatively, the user can choose the dropdown for Inherent risk of that assertion and confirm that the ‘none’ is appropriate by entering a comment in the ‘Edit justification’ box, as below.



12.53 Our assessment of risks of material misstatement does not normally include the presentation and disclosure assertions since this is covered by specific mandatory procedures (including completing a disclosure checklist). However, where a significant risk has been identified, including fraud risks, this should be recorded in the identified risks screen.

12.54 For completeness, if the user wishes to record the risk and response for the presentation and disclosure assertions, this should be entered by one of the methods set out above (ie, either as an identified risk of the type ‘Material classes not otherwise tested’ or as a justification in the assertion PD).

12.55 Note that there is an option to assess the remaining risks for the area after excluding the identified risks. **This should normally be unnecessary.** If after our review of the audit area, we conclude that there are other risks we should include, we should be able to identify and assess these risks. In this case, we should show them as identified risks and therefore go through the required process for these risks.

Keeping information for next year

12.56 Choosing ‘Keep risk record on balance forward’ in the Identified Risks screen will retain this risk so that it appears automatically on the list for next year.

12.57 The user should always choose this if there is a fair likelihood that a similar situation will apply next year. This will save time in next year’s audit planning.

13 Determining the nature, timing and extent of audit procedures

13.1 Note that a detailed consideration of the types of audit procedures is included in section C.

13.2 The process of determining the nature, timing and extent of audit procedures has the following stages, which is applied to each material class of transactions, account balances or disclosures:

a) Assessing the extent of audit evidence required. This arises primarily from our assessment of the Risk of Material Misstatement. Where the risks are highest, more evidence is required.

b) Determining the range of procedures available to us. This will be based on our assessment of the quality of the client's information systems, our understanding of the client's business and our experience from previous audits. As an example, we might assess that there are not adequate efficient controls in the area for us to even consider tests of control.

c) Identifying those matters which need to be addressed in a certain way. In particular, risks relating to material classes will always require substantive tests and significant risks will always require tests of detail.

d) Assessing the impact of mandatory procedures on our audit, including the use of disclosure checklists.

e) Assessing the most efficient combination of methods. Over time, this assessment can be based on our past experience, using information about the staff time and cost involved.

13.3 The user will apply the process above in response to material risks, through using the Identified Risks procedures as set out in section 11.

13.4 Audit Automation will produce an audit programme for those areas that have been identified as relevant to the client. This will include the audit procedures chosen through the Identified Risks process and the procedures included in the firm's standard audit programmes in previous years.

13.5 This proposed audit programme must be reviewed to determine whether the procedures, taken together:

a) On the one hand, are broad enough and extensive enough to form a valid basis for the conduct of the audit and the forming of an opinion on the accounts; and

b) On the other hand, are not excessive, duplicated or unbalanced.

13.6 We should be able to see clearly that our audit procedures include all material matters and are focussed primarily on the key risks.

14 Discussion with the audit team

14.1 ISA 315.17: 'The engagement partner and other key engagement team members shall discuss the application of the applicable financial reporting framework and the susceptibility of the entity's financial statements to material misstatement.'

14.2 The audit team discussion of risks and the significant decisions reached must be documented.

14.3 The guidance material (A42-A47) indicates that the discussion should include:

a) More experienced engagement team members, including the engagement partner, will share their insights based on their knowledge of the entity.

b) Engagement team members will exchange information about the business risks to which the entity is subject, how inherent risk factors may affect the susceptibility to misstatement of classes of transactions, account balances and disclosures, and about how and where the financial statements might be susceptible to material misstatement due to fraud or error.

c) Engagement team members will gain a better understanding of the potential for material misstatement of the financial statements in the specific areas assigned to them, and how the results of the audit procedures that they perform may affect other aspects of the audit, including the decisions about the nature, timing and extent of further audit procedures. In particular, the discussion will assist engagement team members in further considering contradictory information based on each member's own understanding of the nature and circumstances of the entity.

d) ISA 240 requires the engagement team discussion to place particular emphasis on how and where the entity's financial statements may be susceptible to material misstatement due to fraud, including how fraud may occur.

e) Professional scepticism is necessary for the critical assessment of audit evidence, and a robust and open engagement team discussion, including for recurring audits, may lead to improved identification and assessment of the risks of material misstatement.

f) Another outcome from the discussion may be that the auditor identifies specific areas of the audit for which exercising professional scepticism may be particularly important, and may lead to the involvement of more experienced members of the engagement team who are appropriately skilled to be involved in the performance of audit procedures related to those areas.

14.4 With regard to the discussion about disclosures, matters include:

a) Changes in financial reporting requirements that may result in significant new or revised disclosures;

b) Changes in the entity's environment, financial condition or activities that may result in significant new or revised disclosures, for example, a significant business combination in the period under audit;

c) Disclosures for which obtaining sufficient appropriate audit evidence may have been difficult in the past; and

d) Disclosures about complex matters, including those involving significant management judgment as to what information to disclose.

General Planning Memorandum

14.5 It will usually be appropriate for the audit team meeting to consider a draft of the general planning memorandum.

15 General planning memorandum

15.1 The culmination of the planning will be the **General Planning Memorandum** covering:

a) the reporting requirements;

b) the ownership and management structure including management responsibilities;

c) a description of the client's business and how it is organised, including a summary of:

   i) significant developments and key events in the period under review;

   ii) current operating performance; and

   iii) significant transactions

d) a brief description of the client's accounting system, with our assessment of its adequacy. The description should highlight complex transaction streams and hard-to-audit areas, together with key management information systems relevant to the audit. It should also briefly describe any problems identified by the **General IT Risks Checklist**.

e) the conclusions from our **Preliminary Analytical Review**, highlighting:

   i) financial statement areas which may be materially misstated and on which we need to focus additional audit effort;

   ii) any indication of potential going concern problems.

f) A list of non-material financial statement areas on which no further work is to be done and the justification for this;

g) an overview of the audit strategy, identifying the key audit risks and our intended audit approach.

15.2 The planning memorandum should be a summary document that highlights the key matters, with references to relevant detailed documentation in Audit Automation.

15.3 The stages involved in developing the general planning memorandum are as follows and are controlled by the **Audit Planning Checklist** (Schedule B-CL1):

a) Review information obtained from our experience with the entity and from audit procedures performed in previous audits

b) Review our understanding of the applicable financial reporting framework

c) Determine financial statement areas

d) Perform preliminary analytical review

e) Consider whether there are likely to be going concern problems

f) Determine materiality and performance materiality, and the threshold above which misstatements cannot be regarded as clearly trivial to the company.

g) identify the risks of material misstatement at the financial statement level and the assertion level for classes of transactions, account balances and disclosures

h) Determine if any of the identified risks constitute significant risks

i) For identified risks of material misstatement at the financial statement level, design overall responses

j) For identified risks of material misstatement at the assertion level, design appropriate audit procedures

k) Discuss with all members of the audit team the risks identified and susceptibility of the entity to fraud.

16 Communicating with the client

16.1 Once the General Planning memorandum has been completed, we should communicate the audit plan to the client. For larger clients, this is best done by means of an Audit Planning Letter covering, inter alia:

a) any minor variations to our terms of engagement which do not require a new Letter of Engagement;

b) personnel involved in the audit this year;

c) an outline of our audit approach including:

   i) significant business and accounting issues we need to address; and

   ii) the concept of materiality (including implications of group materiality, if applicable)

   iii) approach to assessment of and reliance on internal controls

   iv) developments in law, accounting standards and corporate governance reporting

   v) matters raised in the past, not acted on by management

   vi) if appropriate, reliance on internal audit and secondary auditors

d) timetable including work to be produced by the client;

e) reports we will produce including Management Letter;

f) fees and billing arrangements;

g) any special work we have agreed to undertake.

16.2 For smaller clients, it will not normally be necessary to send a letter, provided the above matters are discussed with the directors and the discussions documented on the audit file. However, sending a letter will ensure such clients are aware of the audit work being carried out.

16.3 If for any matter communicated above, there are no changes from the previous year, it will be sufficient to communicate that there is no new information with regard to that. However, repeating matters may help the client understand our approach.

16.4 Matters already included in the Engagement Letter need not be repeated in the Audit Planning Letter.

16.5 The Audit Planning Letter should:

a) minimise the risk of any misunderstanding between us and the client;

b) improve client's perceptions of the quality of service they receive;

c) provide an opportunity to agree an interim fee, and a basis for billing additional work above and beyond that agreed in the letter.

16.6 The Audit Planning Letter should be sent and agreed with the client at least two months before the commencement of the audit. Ideally it should be sent at least one month before the client's year end to ensure the stocktake procedures are properly co-ordinated, but this may not be practicable for many clients.

16.7 Guidance is given in ISA (UK & Ireland) 260 'Communication with Those Charged with Governance' and 300 'Planning an Audit of Financial Statements'. For Group audits, guidance is given in ISA (UK & Ireland 600 'Special Considerations - Audits of Group Financial Statements (Including the Work of Component Auditors)'

C RISKS AND THE AUDIT RESPONSE TO RISK

1 Manual override of audit areas

When the system initializes the audit programmes and checklists, it makes a number of decisions to customise the pack and produce only those tests that are relevant. The process uses the following logic:

(i) Top level

For each audit area, do the nominal accounts relating to this area contain any figures, or is there any other trigger set for the section? If not, omit the section completely.

(ii) Second level

For each audit program and checklist, do the nominal accounts relating to items contain any figures? If not omit the test, question or section concerning these items.

(iii) Third level

For each audit program and checklist, is the answer to the Tailoring questions relating to the section Y or N? Either include or exclude the tests or question as appropriate.

There may, however, be occasions when using the figures alone will not produce the desired result. For example, if the figures used do not reflect a valuation carried out during the year, which will be incorporated in the final accounts, this may have arisen as the current year's accounts have not yet been prepared, and you are relying on projected or estimated figures, or the revaluation has not been included in the draft accounts.

On the above logic the revaluation section of the tangible fixed assets programme will be omitted. The user can, however, override the system in such cases and this is done using the pop up menu in the Audit area risk dialog.

2 Customising the standard audit programmes

Customisation of the standard audit programme is carried out in two stages, first the system carries out an initialisation of the programmes automating exclusion of tests which do not appear to be relevant to the client, and then you may further customise the programmes, activating and inactivating tests for the client, changing the wording of existing tests and adding new tests.

After the programmes have been initialised, you may then customise them by selecting Customise audit programmesfrom the Planningmenu.

Using this facility the planner can toggle standard tests as active or inactive, change the wording of standard tests, add new tests and allocate team members to carry out tests, with budget time if appropriate.

3 User designed audit programmes

The CCH master packs also include a pool of audit tests that are available for you to incorporate in client's programmes. These are available when you carry out risk assessment and are designing the audit procedures in respect thereof. You may also edit the text of these tests and add tests of your own.

4 Quantifying the risk of material misstatement

4.1 Audit risk is the risk that we may unknowingly fail to modify our opinion appropriately on financial statements that are materially misstated, ie that we give an unqualified audit opinion when it should have been qualified.

AUDIT RISK equals

RISK OF MATERIAL MISSTATEMENT (ie Inherent Risk x Control Risk)	X	RISK THAT WE DO NOT DETECT A MATERIAL MISSTATEMENT (ie Non Sampling and Sampling Detection Risk)

4.2 Our audit objective is to 'obtain sufficient appropriate audit evidence to determine with reasonable confidence whether the financial statements are free from material misstatement'.

4.3 This 'reasonable confidence' is quantified in this manual as the need to be 95% confident that there are no material misstatements present in the financial statements (and therefore, we are willing to accept an Audit Risk of 5%). This is to say that, if there is a material misstatement in the financial statements, we want to be 95% certain of picking it up. 95% is generally accepted within the UK Auditing Profession.

4.4 Our sampling sizes are calculated on that 95% basis, but the reality is that the confidence level attained is normally much higher because users will focus on high risk areas and will often carry out additional work in these areas, though sometimes in ways which are difficult to quantify the cumulative effect of.

4.5 Our audit sampling size, therefore, is <u>the minimum required</u>. There is an overriding requirement for us to review the results of our initial procedures and identify key uncertainties, which will often lead to additional work being carried out.

Detection risk and substantive procedures

4.6 Whilst we can assess inherent risk, control environment strengths and control procedures risks, we cannot control them. However, we can control our detection risk, which is the risk that our substantive procedures fail to detect a material misstatement that has occurred.

4.7 There is an inverse relationship between the inherent risk and the level of detection risk we can accept in planning and performing our substantive procedures:

a) where the inherent risk of material misstatement is high, we should perform more extensive substantive procedures to restrict detection risk to an appropriately low level; and

b) where the inherent risk of material misstatement is low, we can accept a higher level of detection risk and can perform less extensive substantive procedures.

4.8 This is an important concept because we can therefore focus our audit effort on those matters where the identified inherent risk is highest. Therefore, the percentages applied from the table below will lead to higher sample sizes for higher risk levels.

Inherent risk

4.9 As set out in section 11.25, Inherent risk is the susceptibility of an assertion to a material misstatement, before consideration of any related controls.

4.10 Inherent risk is a function of the industry in which the client operates, the unique characteristics of the particular client and the nature of the financial statement areas. Some factors will tend to produce a higher level of risk than others. Also, each factor is unlikely to have the same potential impact on each area of the financial statements.

4.11 General inherent risk levels (see section 5) are calculated for general guidance only and do not form part of the sample size calculation.

4.12 As set out in the previous section, when specific risks of material misstatement are identified, the user rates the risk on a scale of None (trivial) to 5 (highest).

4.13 The system uses these ratings as part of its calculations of the residual risk to be covered by substantive sampling. The percentages corresponding to the level of inherent audit risk are as follows:

Risk level	Percentage
5	100%
4	75%
3	50%
2	35%
1	20%
None	0%

Control risk and procedures to detect the failure of controls

4.14 Control risk is the risk that the client's system of internal control fails to prevent, detect or correct material misstatements within the financial statements (ISA 315.4).

4.15 General control environment risk levels (see section 5) are calculated for general guidance only and do not form part of the sample size calculation.

4.16 For risks identified at the assertion level, our policy is to not carry out tests of control unless we assess the control risk as low (see section 11).

4.17 Where a risk of material misstatement has been identified, you select the level of reliance that you are placing on Controls for that area, and the system uses a lookup table to determine the effect on the audit risk. The table used for the level of reliance is as follows:

Reliance level	Percentage

High	50
Medium	75
Low	(not used)
None or N/A	100

4.18 If you indicate that you are placing reliance on controls, Audit Automation will insist that you design the procedures to test that the controls operate. A higher reliance will require a higher number of tests for each key control (30 as compared with 12), thereby reducing the risk that we will not detect control failures.

Procedures to detect misstatements

4.19 Our detection procedures are divided into two types:

a) Non sampling methods

b) Sampling methods (tests of detail)

4.20 Non sampling methods are those procedures that contribute to our audit comfort but do not rely on sampling transactions. This includes our analytical review work and assurance that we can take from auditing related audit areas.

4.21 As part of planning, we consider whether there are appropriate analytical procedures which would help us detect material misstatements, and decide on the level of reliance that we are to place on non-sampling methods and using the following table as a guide:

Reliance on Analytical Substantive Procedures

		Nil	**Restricted**	**Significant**
Assurance from related audit areas	**Nil**	None	Low	Medium
	Limited	Low	Medium	High
	Strong	Medium	High	High

The following table shows the numerical effect of non-sampling detection procedures:

Reliance level	**Percentage**
High	25
Medium	50
Low	75
None	100

4.22 Note that if there is no assurance from related audit areas, our maximum reliance level is 'medium'.

4.23 Audit Automation will apply these percentages when calculating the total audit risk for each audit area and assertion on which the sample size will be based.

4.24 If you indicate that you are placing reliance on non-sampling methods, Audit Automation will insist that you design procedures you consider adequate to evidence the level of reliance you are taking.

Calculation of residual audit risk and the resulting sample sizes

4.25 In our model, the total remaining audit risk before substantive sampling is calculated by multiplying together the various percentages shown above for each element:

Residual audit risk = Inherent risk X Effect of Reliance on controls X Effect of Reliance on non-sampling substantive methods

This calculates the remaining risk to be addressed by substantive sampling.

4.26 Another way of understanding this is to consider it as the multiplication of risks:

Audit Risk (AR) = Inherent risk of material misstatement

x Risk that the client's controls will not prevent the misstatement and our tests of control do not detect the control failure

x Risk that our non-sampling substantive methods will not detect it

(up to this point, the result is the "residual risk", which we address by tests of detail)

x Risk that our sampling methods will not detect it

(this is the final audit risk, which in our methodology needs to be below 5%)

4.27 For the tests of control, there are two factors: the control risk we identify and our own detection risk. Since we are only using tests of control where we assess the control risk as 'low', the only variable is our testing size, which affects our detection risk.

4.28 From the first three items above, the system will calculate the residual risk to be covered by substantive sampling and uses a lookup table to determine sample sizes, intervals and risk factors for use in the sample calculator.

4.29 Two figures are calculated:

a) A sample size for attribute sampling;

b) A sample interval factor, for monetary interval sampling and risk factor. This factor is the multiple to apply to the Audit Materiality to arrive at the Sample Interval. It is also used in the Stratification Calculator as the sample factor for the test for which the sample is being calculated.

4.30 The table used is as follows:

Risk Band Upper Limit	Sample Size	Sample Interval
100%	60	0.50
95%	58	0.55
90%	58	0.55
80%	54	0.60
75%	50	0.65
68%	48	0.70

60%	44	0.75
56%	40	0.80
45%	30	0.90
40%	25	1.00
34%	20	2.00
25%	15	3.00
20%	10	4.00
18%	8	4.50
15%	5	5.00
14%	0	N/A

4.31 Where there is a residual risk of higher than the minimum set in the table, Audit Automation will insist that you design the procedures to carry out to provide evidence that the risk has not resulted in a material error in the financial statement area.

4.32 There are also maximum limits for the calculated sample sizes, eg 60 for the highest risk setting.

4.33 Note that even if the application of the software produces a zero sample size, this might not be acceptable in certain circumstances set out in the ISAs:

- **Significant risks** ISA 330.21: '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.'

ie - If only substantive procedures are being applied, this must include tests of detail.

- **Material classes** ISA 330.18: '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.'

ie - If substantive analytical review is not being applied, you must perform tests of detail.

5 Tests of control (TOCs)

5.1 Tests of Control are only used where we indicate that we wish to place reliance on Controls. We are not required to take such reliance and will generally not do so because the amount of assurance achieved from the systems work is often not justified by the subsequent reduction in substantive procedures.

5.2 It may be efficient to consider placing reliance on controls where:

a) management control the business through the operation of detailed control procedures, as may be the case with a company with an extremely large number of low value transactions (such as a supermarket);

b) we have to report on the operation of detailed control procedures to Regulators, as may be the case with Financial Services clients. In these cases, since we have to do the systems work in any case, we might as well take the audit assurance available from them.

5.3 In order to place reliance on internal controls:

a) the controls need to be evaluated;

b) TOCs need to be performed.

Evaluation of control procedures risk

5.4 Reliance on controls can be taken if 'key' controls can be identified. A key control must be a control:

a) which, if operating effectively, will assist in satisfying our control objectives (see Appendix 5);

b) which, if operated effectively, will contribute significantly towards ensuring that the accounting system produces reliable information;

c) which is capable of being subjected to TOCs.

5.5 If we find that there are several control procedures directed towards the same assertion, we may not need to rely on all of them:

a) if we decide that the potential for material misstatement remaining undetected is reduced only if two related controls are properly operated, we should regard the two controls as key, since a breakdown in one of them would render both controls ineffective;

b) if we find two controls which individually reduce the potential for the same type of material misstatement we may only need to test one of them - the one which we consider contributes most directly to the control objective.

Tests of control

5.6 Where we are planning to place reliance on internal controls, on the basis that our preliminary assessment of the controls indicates that this is appropriate and it will be efficient to test them, we need to:

a) carry out TOCs. Sample sizes for each key control are:

	PLANNED LEVEL OF RELAINCE	
	Medium	High
No deviations found	12	30
One deviation found	24	60

If more than one deviation is found, no reliance can be placed. A deviation is where the control has not operated as it should eg a signature is missing, even if there is no monetary error. When testing controls to enable us to report on their effectiveness to a Regulator, a planned level of medium reliance will generally be appropriate.

b) where there is more than one detailed control comprising the key control over an audit assertion, the assurance which can be placed on the control is that which can be placed on its weakest component;

c) the same sample items can be used for walkthrough tests, TOCs and Substantive Samples;

d) if the results of our testing bear out the level of reliance we have taken, we can take the appropriate reduction in our substantive procedures.

5.7 TOCs cannot eliminate substantive audit work by themselves. Regardless of the level of Risk of Material Misstatement and Reliance on Controls, we will always have to carry out some substantive audit procedures.

6 Analytical substantive procedures (ASPs)

6.1 ASPs (ie analytical procedures used as part of substantive testing) involve the examination of relationships between different data to obtain audit assurance. The data used can be financial or non-financial.

6.2 ASPs must be designed specifically for the client, based on our understanding of the client's business. They are likely to be most effective where management is analytical in its use of data and these analyses form the basis of the information systems used by management to control their business. Appendix 4 gives examples of relationships which may be useful in the design of ASPs for clients in particular industries.

6.3 In order for ASPs to be good audit evidence:

a) the data used must be reliable and its reliability will need to be checked;

b) we must have a clear idea of the results we expect before we do the work so that we do not 'fit' any explanations to the observed relationship.

6.4 ASPs are not a 'soft' option compared to Other Substantive Procedures.

6.5 The amount of assurance we can take from ASPs will improve as we observe more relationships either by:

a) increasing the frequency of observation (dividing data into shorter time periods) and using this for comparison;

b) desegregating data into sub classifications (such as product type) and using these for our comparisons.

6.6 In addition, ASPs are cumulative and a number of tests which individually give a low level of assurance, together may give a higher level.

6.7 ASPs can provide one of four levels of assurance:

a) Proof-in-total

b) Significant

c) Restricted

d) Nil

6.8 The level of assurance obtained from the work is a matter of professional judgement and depends on:

a) reliability of base data, which may need to be checked;

b) likely range of our expectations. If we do not expect the results to be close, the level of assurance will be less. Planning the expected results is important to avoid 'fitting' explanations to the circumstances;

c) a lack of circularity

d) frequency of observation. Dividing data into shorter time periods will provide greater assurance;

e) degree of desegregation. Splitting data into its component parts will provide greater assurance.

f) number of procedures. A number of tests which each individually give low levels of assurance can accumulate to give a higher level of assurance.

6.9 Proof-in-total means that the theoretical value of a balance, computed from independent or otherwise verified information, is sufficiently close to the recorded value to mean that we have effective 'proved' the amount recorded. Any further work on the balance would not add to the assurance already obtained and hence is unnecessary.

6.10 Where ASPs give us a high degree of assurance but this is short of proof-in-total, we may be able to take significant assurance. For example, we may be able to relate salesmen's commissions to sales provided we are satisfied that the sales figure is okay. Where the relationship is straightforward, we may have a proof-in-total of commissions. However, where the relationship is complex (because commission rates are dependent on type of sale and sales volumes) we may only be able to satisfy ourselves that the expected relationship holds and hence is significant.

6.11 ASPs in other circumstances may only give us restricted assurance. Monthly analysis of sales or expenses compared with prior periods or with industry norms give restricted comfort. The frequency of observation here is important and we would be looking for **expected** seasonality.

6.12 Where the expected results are not achieved no assurance can be placed on ASPs.

6.13 If we are carrying out a proof-in-total type test where the planned level of assurance was limited but the results were spot-on, we cannot take more than the planned level of assurance. If we had expected the result to be as good as that achieved, we would have planned to take that level of assurance.

6.14 The dividing line between significant and restricted is a matter of professional judgement having regard to:

a) the design of the test. Care must be taken to avoid circular arguments (eg because gross profit is as expected, both purchases and sales are correct - to draw any conclusion, either purchases or sales would need to be independently tested).

b) the plausibility of the relationship being used and the assertion being tested;

c) the quality and reliability of the data being used;

d) the precision of our expectations;

e) the corroborative nature of other ASPs applied to the assertion. For example, a number of ASPs which individually give limited assurance, may in combination give consistent assurance provided they are based on different base data. Hence an analysis of sales by product type by month against previous years and budgets may give us significant assurance.

6.15 Since balances comprise two or more transaction streams it is unlikely that more than restricted assurance can be obtained from ASPs in these areas. For example, a comparison of days debtors etc this year and last will not normally give any assurance unless the reason for the change can be clearly explained ('improved credit control' will not suffice unless the expected improvement can be quantified). In order to get even restricted assurance from such a procedure, it will normally be necessary to do the comparison on a monthly or quarterly basis.

7 Assurance from related audit areas

7.1 Obtaining audit evidence is a cumulative process. Throughout the audit work we may collect evidence that may provide assurance, directly or indirectly, toward other audit assertions. For example, in carrying out a debtors circularization, we aim to obtain evidence about the existence and accuracy of trade debtors. However, this procedure may also provide evidence about.

a) existence and accuracy of sales;

b) completeness and accuracy of receipts;

7.2 NB: a test on the existence of debtors gives evidence about the completeness of receipts rather than existence since if debtors are overstated this is because either sales are overstated and/or because cash receipts are understated (ie are missing and therefore incomplete).

7.3 This arises because financial statement area assertions are interrelated through the accounting which in the case of sales is expressed as:

Debtors b/fwd + sales during year - cash receipts during year = Debtors c/fwd

The relationship between creditors, purchases and payments is:

Creditors b/fwd + purchases during year - cash payments = Creditors c/fwd

and between cost records and stock is:

Stock b/fwd + purchases - cost of sales = Stock c/fwd

7.4 Assurance from related financial statement areas can only be taken between areas related by double entry. Hence where the stock figure is inserted and does not come from an integrated accounting system there are no financial statement areas related to stock.

7.5 Work on valuation of one financial statement area rarely gives evidence about the valuation of related areas.

7.6 This relationship is particularly important in determining the extent of the tests of transactions in that assurance from related balance sheet areas can substantially reduce the transactions sample sizes.

7.7 Obviously, if we have strong evidence about transaction streams based on our ASPs this can be taken into account when determining the assurance required for related balances.

7.8 However, we must avoid the circular argument that because debtors are okay, sales are okay and because sales are okay, debtors are okay, ie we can only take the assurance in one direction.

7.9 The degree of assurance obtained from substantive procedures applied to a related financial statements area is a matter of professional judgement. Generally, going from a balance sheet area to transaction streams will give stronger assurance than going from a transaction stream to a balance sheet area. This is because work on a balance will give us assurance on the underlying transaction streams, whereas work on a transaction stream can only give us assurance on one aspect of the balance. Obviously which direction we take assurance will be a question of efficiency.

7.10 We can take three levels of assurance from our audit of a related area:

a) Strong

b) Limited

c) Nil

7.11 The level of assurance will depend on:

a) nature and extent of procedures applied to the related area. The more reliable the procedures the more assurance we can take;

b) extent of relationship between transactions streams and balances. Where a high percentage of sales are cash sales, work on debtors will give less assurance about sales than where few sales are cash sales;

c) results of tests on related areas. Where the results of work on an area lead us to suspect that these could be misstatements in related areas, we could not take any assurance in related areas unless we are satisfied that the possible misstatements have been corrected.

7.12 Within Audit Automation, the amount of reliance that we take on Non Sampling methods will be based on our assessment of the amount of reliance taken on Analytical Substantive Procedures and assurance from related audit areas. The following table may be used as a guideline for the overall level of reliance applied.

		Reliance on Analytical Substantive Procedures		
		Nil	**Restricted**	**Significant**
Assurance from related audit areas	**Nil**	None	Low	Medium
	Limited	Low	Medium	High
	Strong	Medium	High	High

8 Other substantive procedures (OSPs)

8.1 Whatever audit assurance we cannot get from our other procedures, we need to obtain other substantive procedures. This will usually require tests of detail, and will usually involve taking a sample of a pool of transactions or balances.

8.2 OSPs will not always require sampling. For example, the reperformance of a bank reconciliation to gain assurance about year-end bank balances will not involve sampling.

8.3 Sampling might not need to be random. For example, a highly skewed population might comprise four or five substantial items and a number of smaller ones. If we are testing for existence or value, we can choose the larger items and in doing so reduce the untested population to below Performance Materiality, the untested items will not need to be sampled since they could not contain a material misstatement.

8.4 Where appropriate, Audit Automation will have calculated a sample size and interval based on the risk profile of the client and will show the size or interval that should be applied to each test.

8.5 If the population is not homogeneous, it needs to be stratified. A homogeneous population is one in which little or no variability exists between items in the population to be sampled. The purpose of stratification is to reduce the variability between sample items. This will increase the accuracy of the estimate of projected error in the population.

8.6 The normal way of stratifying is to divide the population between those above the level of materiality and select all of those for testing. The balance of the population, calculated by deducting the key items, and other items that have been verified elsewhere, will be subjected to the following calculation to evaluate the number of items that should sampled from it:

$$\text{Sample size} = \frac{\text{Population}}{\text{Materiality * Audit area factor}}$$

8.7 A Stratification Calculator is provided in Audit Automation to allow this calculation to be carried out.

8.8 Three sampling methods can be used:

a) monetary unit sampling (which gives automatic stratification since larger items have more chance of being selected);

b) systematic sampling, ie selecting any nth item;

c) random sampling using random number tables.

9 Audit fieldwork

9.1 The fieldwork stage of the audit comprises both performing the planned audit procedures and continually evaluating them in the light of further information obtained during fieldwork.

9.2 The planned procedures may need to be amended during fieldwork. However, all amendments should be agreed with the manager and be fully documented.

9.3 The Audit Programmes will have been tailored as part of the planning using the facilities in Audit Automation to customise audit programmes. The tests should cross referenced to the audit assertions to:

a) assist with the tailoring, ensuring that all assertions are covered, specific inherent risks have been taken into account and the audit work is properly focused. For example, if there is a risk that sales are overstated, the direction of testing will need to be set accordingly;

b) ensure that the person doing the work understands the objective of the procedure.

9.4 It is important that higher risk and highly significant financial statement areas are dealt with earlier in the audit rather than towards the end. In this way we are more likely to become aware of problems early in the audit, enabling them to be dealt with more effectively and efficiently.

9.5 When carrying out Other Substantive Procedures (OSPs) it is important that the assertion is considered and:

a) items to be tested for completeness are selected from source or reciprocal populations and tested forwards to the nominal ledger. It is important that this population is complete, otherwise no valid conclusion can be drawn. Hence the population may need to be tested for completeness by inter alia:

   i) sequence testing it

   ii) selecting the sample as every nth number between the first and last number in the sequence. If an item cannot be found, this is prima-facie evidence that there is a completeness problem. Thus, for example samples for sales completeness should be selected from source documents such as sales orders, or signed delivery notes - selecting a sample from the invoices will only prove that sales invoiced have been completely recorded, not that all sales have been recorded. Similarly, samples for creditors completeness testing should be based on volume of trade with suppliers or a list of approved suppliers and it should not be based on the list of creditors balances since selecting a sample from this will only ensure that recorded liabilities are complete, not that liabilities are complete.

b) items to be tested for existence and accuracy are selected from the nominal ledger and tested back to a source document to ensure they are valid and for the purposes of the business.

9.6 All the work on the tailored audit programme should be carried out. If for any reason a test is not practicable:

a) the reason should be considered to ensure it is not indicative of a more serious problem such as fraud or to limit the scope of our work. The reason and these considerations should be documented.

b) an alternative procedure designed and agreed with the manager.

10 Evaluation of work done

10.1 All work done must be documented and the results of each test evaluated properly. When testing a sample of items, all those selected should be completely tested. If an item cannot be found, it should be treated as a deviation or error and evaluated accordingly - an alternative item must not be selected and tested instead (the sample might be extended, but the missing item must still be recorded as an error).

10.2 When audit evidence from one source is inconsistent with that from another, the reliability of both should be in doubt, pending resolution of the inconsistency. We should not assume without further investigation that the evidence from the source believed to be more reliable iscorrect.

10.3 It is usually helpful for the manager to review portions of the audit file during the audit, thereby keeping aware of progress and identifying any additional work before the audit team leave the client's premises.

Evaluation of tests of control (TOCs)

10.4 When evaluating TOCs, the table in paragraph 2.6 above is relevant. If more than one deviation is found, the Reliance on Controls reverts to none and the consequential changes need to be made to the audit plan. If our planned reliance was high and we found one deviation in our sample of 24 we could either take an actual level of medium or test a further 24, and provided no further deviations are found the actual level reliance could be left as high. If another deviation is found in the additional 24 items then no reliance could be taken. Once a second deviation is found, the sample can be abandoned (unlike substantive samples, which must always be completed).

10.5 If we do not achieve our planned level of reliance:

a) the audit should be replanned accordingly and the revised plan will need to be agreed with the manager;

b) the result should be reported to the client and be included in the Management Letter;

c) if we are reporting to a Regulator on the effectiveness of the control systems, we need to consider whether we need to make an ad-hoc report to them in accordance with ISA 250A 'Consideration of laws and regulations in an audit of financial statements' and 250B 'The Auditor's Statutory Right and Duty to Report to Regulators of Public Interest Entities and Regulators of Other Entities in the Financial Sector'.

10.6 It is possible that the variation in the level of reliance taken does not affect the whole of the audit area but just the sample sizes of one or more tests within it. Audit Automation includes a Risk Recalculation Calculator that allows you to recalculate the sample size for a selected test based on a change in the assumptions made of the risk profile at the planning stage.

Evaluation of analytical substantive procedures (ASPs)

10.7 The results of an ASP may suggest that the object of the ASP is materially misstated. There are two possible explanations:

a) the ASP is inappropriate. If this is the case, we need to understand why and make an efficiency note for future years. The results can then be ignored;

b) the ASP has identified a misstatement, which must be followed up.

10.8 We cannot assume the former without investigation, and any reasons for unexpected results mustbe corroborated. In particular, we cannot accept client explanations for unexpected results without further work to establish whether the explanations are correct.

10.9 If the actual assurance from ASPs is less that the planned assurance, we need to replan our audit accordingly. The revised plan should be agreed with the Manager.

Evaluation of other substantive procedures (OSPs)

10.10 To evaluate the results of our OSPs we need to project the known errors over the population. These projections need to be done on a stratum by stratum basis. If the total projected error is close to or greater than Planning Materiality there is an indication of a material misstatement which must be followed up. The known and projected errors need to be recorded in the Audit Journal Routines within Audit Automation. It should be noted that we cannot adjust for projected errors, only known errors and Audit Automation enforces this.

10.11 As well as considering the quantitative aspects of errors we need to consider the qualitative aspects including their frequency and cause. For example, very small errors in say 25% of the items in the sample could be just as indicative of the possibility of a material misstatement as a small number of larger errors.

10.12 If it is concluded that further work is required, the Manager should be notified immediately. Ideally the client should resolve the problem and we should test the work done. If it is decided that we, rather than the client, are to do the work the Manager should discuss the matter with the Partner and one of them should discuss the fee and timetable implications with the client.

11 Going concern and other issues

Subsequent events

11.1 The subsequent events review needs to be updated from the end of the fieldwork to the date of signing the audit report. This will often be done as part of the closing meeting and must be documented.

Going concern

11.2 For all audits, going concern considerations need to be reviewed and documented. We therefore need to:

a) assess the directors' approach and views taken;

b) consider whether the period to which the directors have paid particular attention is reasonable in the circumstances and covers the 'foreseeable future'. This foreseeable future should ideally be 12 months after the date of approval of the accounts. If the period is shorter we should consider whether the period covered is adequate. If we consider it is not and the disclosures in the financial statements are not appropriate, we should cover the matter in the audit report, but it should not result in a qualification.

c) consider the likely impact of contingencies, particularly as regards breaches in laws or regulations.

d) consider the need for written confirmation of representation made and the directors' view in the Letter of Representation.

11.3 If matters of concern are identified we should consider:

a) the availability and reliability of budgets prepared paying particular attention to:

   i) the appropriateness of key assumptions;

   ii) the sensitivity of the budgets to factors within/outside the control of the directors.

b) obligations, undertakings or guarantees with other entities for the giving of support. If the client is relying on such support from lenders, suppliers, group companies and directors, we need to consider their ability as well as the intention to provide such support.

c) the adequacy of borrowing facilities and supplier credit. In doing this we need to consider:

   i) the headroom within the facilities ie the difference between the facility and the maximum overdraft credit expected to be needed. Where there is little or no headroom, the sensitivity of the assumptions is crucial and must be considered.

   ii) the review date of facilities and the likely outcome of the review. If the review is likely to result in a reduction in the facilities, or in additional conditions being imposed, this lower figure should be used when considering headroom.

   iii) the likelihood of breaches in covenants/warranties and the likely effect of such breaches.

d) plans for resolving matters giving rise to concern and their likely success.

e) the adequacy of disclosure where concerns exist. The disclosures should cover:

   i) a statement that the financial statements were preparedon a going concern basis.

   ii) a statement of the pertinent facts;

   iii) the nature of the concern;

   iv) a statement of assumptions (distinguishable from facts);

   v) where appropriate and practicable, a statement of plans for resolvingthe problems.

   vi) details of any relevant actions taken or to be taken.

f) An example of such disclosure is the following addition to the creditors note:

'The company meets its day to day working capital requirements through an overdraft facility which is repayable on demand. The company expects to operate within the facility currently agreed and within that expected to be agreed on (date), when the company's bankers are due to consider its renewal for a further year. These views are based on the company's plans and on the successful outcome of discussions with the company bankers'.

11.4 Guidance is given in ISA (UK & Ireland) 570 'Going concern'.

11.5 Our working papers must document the above considerations.

11.6 If we consider the disclosures given in the financial statements to be inadequate, we need to qualify our audit report on the grounds of disagreement and include the information we consider necessary in the audit report.

11.7 In cases where the degree of concern is judged to be significant, a note to the financial statements alone is not considered to be adequate. In such a case a reference in the audit report is also necessary. This should appear as a paragraph sub-headed 'Going Concern' at the end of the basis of opinion paragraph.

Capital, reserves and statutory matters

11.8 Section N and O and in particular the review of minutes should be completed as early in the audit as possible. Ideally the minutes should be reviewed at the planning stage to ensure that significant matters arising are included in the audit plan. If this is not practicable, the minutes should be reviewed at the beginning of the fieldwork to ensure there are no significant matters which impact on the planned audit procedures.

11.9 If the firm does not assist the client in company secretarial matters we should consider the need to periodically carry out a company search to confirm the accuracy of the statutory records.

Contingencies

11.10 Contingencies can arise from:

a) non-compliance with law and regulations (see Section 3.4 above).

b) litigation and claims

c) guarantees or security given against credit facilities for directors, group companies, related parties and other third parties.

d) forward purchase commitments (eg options, foreign currency).

e) discounted bills of exchange/letters of credit receivable.

f) warranty claims.

g) lease commitments

h) customer or employee incentive schemes.

i) unprovided deferred tax.

j) unpaid pension commitments.

k) onerous contracts.

l) decommissioning costs

11.11 Their existence and likely outcome need to be considered and documented to ensure compliance with IFRS or UK GAAP.

11.12 Evidence should be obtained from:

i) enquiries of management

ii) bank certificates

iii) invoices from solicitors. If considered appropriate, direct confirmation from the solicitors should be sought. The Law Society has instructed its members to only reply to specific enquiries (not general ones) and hence it might be difficult to obtain a satisfactory response.

11.13 The letter of representation should include confirmation from the directors that they have disclosed all events that could give rise to a provision or a contingency to us.

12 Audit completion

12.1 The key to an efficient and economic audit completion is to ensure that any issues are dealt with as they arise rather than being accumulated throughout the audit and dealt with at the end. Whenever an issue is half-dealt with, its final resolution will take longer than fully resolving it at an early stage.

12.2 It is usually helpful for the Audit Manager to review portions of the audit file during the audit, thereby keeping aware of progress and identifying any additional work before the audit team leave the client's premises.

12.3 Audit points will be raised by both senior and manager, and will form part of the basis for our Audit Completion Memorandum.

12.4 Review points will be raised by the manager, who should ensure that the Audit Senior understands and clears the review points as quickly as possible.

12.5 Where possible, individual audit areas should be brought to full completion during fieldwork and reviewed by the Audit Manager, who will sign off the area where it is clear that the work on the section is complete.

12.6 The Audit Senior should complete the file before the final manager review. This includes:

a) drafting the financial statements and draft audit report

b) drafting the letter of representation

c) completing the post balance sheet events reviews up to the end of the fieldwork and considering going concern. If there are likely to be going concern problems, the necessary information should be gathered and filed there.

d) confirm that all notes to Senior have been cleared or elevated to the Manager's attention

e) carrying out an Overall review of the financial statements

f) reviewing the Summary of Unadjusted Errors, ie the potential journals, and considering whether, as a result, further audit work is required and if so, planning it in conjunction with the Manager

g) completing the review of the work of sub-ordinates and ensuring the points are adequately cleared

h) noting outstanding matters

i) noting any points forward to next year

j) reviewing actual time spent to date to budget and noting reasons forany significant variances

k) drafting Staff Appraisal forms for sub-ordinates where appropriate

l) drafting Management Letter or notes for Partner to discuss with client

Reviews by manager and partner

12.7 All work done should be subjected to a detailed review, normally by the Manager. This includes the update of the Permanent Audit File at the planning stage.

12.8 In certain cases it may also be appropriate for the detailed review of certain sections of the file to be carried out by the Audit Senior. If this is the case it should be agreed at the planning stage. Where a Senior or other member of staff works directly for a Partner, the Partner will need to carry out the detailed review of the file.

12.9 The Audit Manager should complete a final review as soon as possible after the end of the fieldwork.

12.10 The Manager should clear as many outstanding points as possible and elevate the rest to the Partner's attention.

12.11 The Partner should review the file as soon as practicable. This includes:

a) A detailed review of schedules produced by the Manager (eg key audit issues)

b) A general review of the file. This general review should concentrate on Sections A and B and any critical sections. It should not replicate the Manager's detailed review.

12.12 File reviews are evidenced on screen by signing off each audit area. Review of detailed schedules will either be evidenced by the reviewer entering details on the face of the document on screen or by writing on the printed copy of the working paper.

12.13 Where relevant, the Manager should arrange a time for a second partner review and ensure that relevant issues are clearly documented for this review.

12.14 The Partner and/or Manager should discuss and agree changes to the financial statements with the client.

Summary of unadjusted errors (potential journals)

12.15 The effects of all immaterial misstatements found during the execution phase of the audit need to be aggregated by profit and balance sheet area and the overall effect on our opinion considered. It is important that this is done because a number of errors that are not individually material can in aggregate be material.

12.16 The schedule of potential journals produced by Audit Automation summarises the unadjusted areas showing the effect on the total profit – shown as a figure and a percentage. The unadjusted journals are also summarised by classification thereby providing all of the information you require to conclude on their effect.

13 Overall review of financial statements

13.1 An overall review of the financial statements needs to be carried out

13.2 The object of the Overall Review of Financial Statements is to evaluate:

a) whether they are reasonable and consistent with our knowledge of the client's business; and

b) whether audit evidence is sufficient to support unusual or unexpected relationships within them.

13.3 All significant variations should be explained. If they cannot be explained it may indicate that we have insignificant audit evidence to support the financial statements.

13.4 In addition, the review should consider:

a) whether the scope of our audit work is adequate based on the results of our testing. The risk of material misstatement and materiality should be reviewed in the light of the audit findings and amended if necessary. The scope of the work done should be reviewed in the light of any changes to risk and materiality and any additional work required planned, performed and reviewed;

b) whether the financial statements comply with the Companies Act requirements and applicable accounting standards;

c) the adequacy of disclosures;

d) the effect of uncertainties;

e) the consistency of other financial information issued with financial statements.

Directors' reports

13.5 We must make a positive statement that directors' reports are consistent with the financial statements.

13.6 Guidance in ISA (UK & Ireland) 720 'The Auditor's Responsibilities Relating to Other Information'

13.7 The procedures we should follow in determining whether the information in the Directors' Report is consistent with the financial statements include:

a) reading the Directors' Report,

b) ensuring that any information that has been taken directly from the financial statements has been accurately included,

c) ensuring that any information that is included in more detail than in the financial statements is agreed to the audit working papers or client accounting records, and

d) ensuring that where any information is presented on a different basis to that used in the financial statements, that basis is adequately disclosed, and that the reconciliation of these amounts to those included in the financial statements is checked.

13.8 During the course of this work we might identify an inconsistency such as a simple difference between words or numbers in both places, or the use of a different basis without adequate explanation, or the omission of relevant information in the directors' report (such as stating in the directors' report that profits have increased by 10%, whereas continuing profits have dropped with a one-off profit on discontinued operations). In these cases we should discuss the matter with the directors. If the matter cannot be resolved we will need to describe the inconsistency in our audit report.

13.9 We will have a problem where the presentation of the information in the Directors' Report is misleading but not actually inconsistent with the financial statements, such as statements that are inconsistent with management reports, views stated that are not credible and disclosure in a manner that it is not consistent with our understanding of the underlying issue or use of inappropriate Key Performance Indicators. In such cases we will have to consider our position if the client will not amend the wording and, for example, use our right to speak at the AGM or resign.

14 Letters of representation

14.1 Letters of Representation should be obtained for all clients before the audit report is signed. They should be dated on the date of approval of the financial statements.

14.2 Guidance is given in ISA (UK & Ireland) 580 ‘Written representations’. The Letter of Representation should cover an acknowledgement of directors' responsibilities, confirmation that all relevant information has been made available to us, confirmation re going concern and other relevant matters.

14.3 The Letter of Representation should not be used as a substitute for other audit evidence. If we are unable to obtain sufficient appropriate audit evidence about a material matter where such evidence is expected to be available this constitutes a limitation of the scope of the audit, even if it is covered by a management representation.

14.4 In certain instances, such as where knowledge of the facts is confined to management (for example, when the facts are a matter of management intentions), or when the matter is principally one of judgement or opinion (for example, on the trading position of a particular customer), management representations may be the only audit evidence available. In very exceptional cases where the representation is relevant to a proper understanding of the basis of our opinion, we may need to refer to it in the basis of opinion paragraph in the audit report.

14.5 When representations relate to matters which are material to the financial statements, we should:

a) seek corroborative audit evidence;

b) evaluate whether the representations made by management appear reasonable and are consistent with other audit evidence obtained, including other representations; and

c) consider whether the individuals making the representations can be expected to be well-informed on the particular matters.

15 Reporting

15.1 Guidance on auditors' reports is contained in:

ISA(UK& I) 700	ISA 700 ‘The Auditor’s Report on financial statements’ applies to all reports issued by auditors which express an opinion in terms of whether financial statements give a true and fair view, or where statutory or other specific requirements prescribe the use of a terms such as ‘presents fairly’ or ‘properly prepared in accordance with’. It therefore applies not just to companies but also to inter-alia Industrial, Provident and Friendly Societies, Pension Schemes, and larger Charities.
ISA(UK& I) 701	ISA 701 ‘Communicating key audit matters in the independent auditor’s report’ deals with the auditor’s responsibility to communicate key audit matters in the auditor’s report. This applies to listed entities, unlisted public interest entities and entities that report on how they have applied the UK Corporate Governance Code.
ISA(UK & I) 705	ISA(UK & I) 705 ‘Modifications to Opinion in the Independent Auditor’s Report’ gives guidance on procedures to be followed when a modified audit report is considered necessary
ISA(UK & I) 706	ISA(UK&I) 706 ‘Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor’s Report’ gives guidance on procedures where the auditor considers it necessary to draw users’ attention to matters in the financial statements that are considered fundamental to the users’ understanding of the financial statements or the audit.
ISA(UK & I) 710	ISA (UK) 710 ‘Comparative Information – Corresponding Figures and Comparative Financial Statements’ relates to the auditors' duties relating to comparative information.
ISA(UK & I) 720	ISA (UK) 720 ‘The auditor’s responsibilities relating to other information’ deals with the auditor’s responsibilities relating to other information, whether financial or non-financial information (other than financial statements and the auditor’s report thereon), included in an entity’s annual report. This mainly affects our review of the directors’ report.
ISA(UK & I) 800 and 805	These deal with special cases: ISA (UK) 800 ‘Special Considerations––Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks’ ISA (UK) 805 ‘Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement’
ISA(UK& I) 570	‘Going Concern’ contains guidance on disclosure requirements and the impact on audit reports of companies where going concern matters have been identified.

ISA(UK& I) 510	‘Initial Audit Engagements – Opening Balances’ contains guidance on auditors' reports where: we are unable to obtain evidence regarding opening balances (ie ‘split opinion’). the report on the preceding period was qualified and the matter has not been resolved. the report on the preceding period was qualified, the matter has not been resolved but does not affect opening balances (ie comparatives affected, not this year’s accounts).

Qualified audit opinions/opinions containing a fundamental uncertainty

15.2 If any member of the audit team considers a modified opinion or an emphasis of matter paragraph is required, the procedures set out in the Policies and Procedures Manuals should be followed.

Dating of the audit report

15.3 ISA (UK & I) 700 requires us to date our audit report with the date on which we sign it ‘in manuscript’. This date should be as close to the date on which the directors approve the accounts, since post balance sheet events reviews must be carried out up to the date we sign our report.

15.4 In practice, with careful management we should be able to date the audit report on the same date as the directors approve the accounts since:

a) It is not necessary for us to delay signing our audit report until we have a final, clean copy. Instead we may sign manuscript drafts, provided that they have been approved by the directors.

b) The directors do not need to sign the drafts to evidence approval. It is sufficient for them to record their approval in the minutes.

c) The draft approved can contain manuscript corrections provided they are sufficiently clear for both us and the directors to assess the overall financial statement presentation. The directors cannot approve the financial statements if there are so many adjustments that the result is illegible. Similarly, approval may have to be delayed if the tax effect of the adjustments has not been calculated.

15.5 Where there is no meeting with the directors and the draft accounts have been sent to them, we must encourage them to notify us promptly when they have approved the financial statement so that we can sign and date our audit report as near as possible to that date. This can be done by telephone or fax since it is not necessary for us to see the directors’ signatures on the balance sheet and directors’ report. A note of the telephone conversation with the directors must be placed on the audit file and the directors should be encouraged to minute their approval.

15.6 If the directors have approved the financial statements subject to further adjustments, then we must consider the impact of those adjustments (if necessary, marking them directly onto our copy during the conversation) and whether any additional audit evidence is necessary as a result. If none is required then we can sign the audit report straight away, otherwise there will be different dates on the directors’ report and balance sheet and the audit report. We cannot sign our report until all the necessary evidence has been obtained and considered.

Going concern

15.7 Our considerations in respect of going concern are set out in Section 8 above.

15.8 In cases where the degree of concern is judged to be significant a note to the accounts alone is not deemed to be adequate. In such a case a reference in the audit report, is also necessary. This should appear at the end of the basis of opinion paragraph.

15.9 The audit report will be qualified where it proves impossible to carry out necessary procedures, but not because of any inherent uncertainty affecting the company. In the exceptional cases where use of the going concern basis is not appropriate, the financial statements should include an explanation of the

16 Reports to management

16.1 A vital part of client service is the provision of pro-active business advice. If we are to provide this we need to communicate our findings from the audit to management or the Audit Committee and produce a good Management Letter within one month of the approval of the financial statements, although ideally before their approval. The information gathering phase of the audit will provide much of the background for the Management Letter. Further guidance is given in ISA (UK & I) 260 'Communication of Audit Matters to those charged with Governance'.

Findings from the audit

16.2 The following must be communicated:

a) expected modifications to the auditors' report

b) unadjusted misstatement which are not 'trifling'. Trifling is not another expression for immaterial. Matters which are trifling will be of a wholly smaller order of magnitude that the materiality thresholds – say, individually less than 10% of materiality and cumulatively less than 30% of materiality.

c) material weaknesses in accounting and internal control systems identified during the audit

d) our views about the qualitative aspects of the client's accounting practices and financial reporting.

16.3 For smaller clients, it will normally be sufficient to discuss the above matters with the directors and document the matters discussed on the audit file.

Management letters

16.4 The main objective of a Management Letter is to provide proactive business advice and to report significant weaknesses in the accounting, control and management information systems. In so doing, we should bear in mind that not all recipients of our reports may be familiar with the details of a particular system or control to which we are referring.

16.5 Another function of a Management Letter is for us to place on record certain significant matters which arose during the audit. Matters such as opinions given to us, or information which it is difficult to confirm by objective auditing procedures, are best recorded in a Letter of Representation (see section). Matters which are appropriate for inclusion in Management Letter are as follows:

a) Undertakings given to us regarding future practices or policies.

b) Views taken by us on particular items or events.

c) Items which we wish to draw to the attention of management.

d) Reservations we might have on any items in the accounts, but which are not of sufficient size or concern to warrant qualification.

16.6 A Management Letter should also be the medium through which we make recommendations of commercial value. As auditors, we are in a position to identify areas of potential cost savings or failures to maximise income, and to make other recommendations of specific commercial value to clients.

16.7 Generally, the Management Letter should be drafted at the client's premises by the Audit Senior who may delegate certain sections as appropriate, taking care to keep the style compatible. The work of drafting should not be left for the Manager to perform.

16.8 Points to be included in the draft should be discussed before leaving the client's premises with an appropriate person, such as the Chief Accountant. This discussion is an important part of obtaining the clients understanding of our observations and recommendations as well as eliminating any errors or misunderstandings in the letter.

16.9 Audit Automation provides a facility to record Management Feedback points specifying your observation, the implications and the recommendation. These can be reviewed on screen and a decision made as the whether the point should be included in the report to management. Points for inclusion can be compiled into management letter schedules for manual editing. The points are carried forward to the next year and those that have been attended to can be deleted and others added as required.

17 Closing the audit

17.1 Before the audit file is closed it is essential that we carry out an audit efficiency review if we are not to lose the lessons learnt during the audit. This Review should cover, inter alia:

a) analysis of variance between budgeted and actual cost;

b) the efficiency of our fundamental approach to the audit and whether alternative approaches could be more efficient;

c) efficiencies that could be achieved in the execution of the detailed audit work;

d) how well the client performed and how it could be improved (including other work the client could do for us);

e) changes in the client's business since the year-end which could impact our audit strategy for the next year.

APPENDIX 1: ASSERTIONS

1 Assertions used in Audit Automation

1.1 The financial statements on which we can express an opinion are presented by management on the basis that they fairly present the income and expenditure for the period and the assets and liabilities at the end of it. This general assertion is made up of a series of assertions by management in relation to each asset and liability, and to each revenue and expense transaction. The audit assertions included in ISA 315 are:

Assertions about classes of transactions and events

a) Occurrence—transactions and events that have been recorded or disclosed have occurred, and such transactions and events pertain to the entity.

b) Completeness—all transactions and events that should have been recorded have been recorded, and all related disclosures that should have been included in the financial statements have been included.

c) Accuracy—amounts and other data relating to recorded transactions and events have been recorded appropriately, and related disclosures have been appropriately measured and described.

d) Cutoff—transactions and events have been recorded in the correct accounting period.

e) Classification—transactions and events have been recorded in the proper accounts.

f) Presentation—transactions and events are appropriately aggregated or disaggregated and clearly described, and related disclosures are relevant and understandable in the context of the requirements of the applicable financial reporting framework.

Assertions about account balances

a) Existence—assets, liabilities and equity interests exist.

b) Rights and obligations—the entity holds or controls the rights to assets, and liabilities are the obligations of the entity.

c) Completeness—all assets, liabilities and equity interests that should have been recorded have been recorded, and all related disclosures that should have been included in the financial statements have been included.

d) Accuracy, valuation and allocation—assets, liabilities and equity interests have been included in the financial statements at appropriate amounts and any resulting valuation or allocation adjustments have been appropriately recorded, and related disclosures have been appropriately measured and described.

e) Classification—assets, liabilities and equity interests have been recorded in the proper accounts.

f) Presentation—assets, liabilities and equity interests are appropriately aggregated or disaggregated and clearly described, and related disclosures are relevant and understandable in the context of the requirements of the applicable financial reporting framework.

1.2 For practical purposes, some of the assertions are combined in Audit Automation:

For account balances:

- Existence, rights and obligations - all recorded assets and liabilities exist at the balance sheet date and belong to the entity.

- Completeness - everything that should be in the financial statements is included there.
- Accuracy, valuation, allocation and classification - balances are included in the financial statements at appropriate amounts in the correct accounts.

For transactions:

- Occurrence - transactions and events that have been recorded have occurred and pertain to the entity.
- Completeness - all transactions and events that should have been recorded have been recorded.
- Accuracy and classification - amounts and other data relating to recorded transactions and events have been recorded appropriately in the correct accounts.
- Cut-off - transactions and events have been recorded in the correct accounting period.

For presentation and disclosure:

- Transactions, events, assets, liabilities and equity interests are appropriately aggregated or disaggregated and clearly described, and related disclosures are relevant and understandable in the context of the requirements of the applicable financial reporting framework.

APPENDIX 2: INHERENT RISK QUESTIONNAIRE

1 Industry regulatory and other external factors

1.1 Are there any external commercial or economic factors that might adversely affect the future financial or operating performance of the entity (3).

Indications of potential risk include:

a) business operates in a high-tech, regulated or declining industry;

b) there are commercial threats to the entity's products or services such as:

- I) greatly increased competition;
- II) strong danger of market saturation;
- III) product obsolescence;
- IV) declining demand.

c) there are rising energy or raw material costs that threaten the entity's competitiveness.

d) there are rising interest rates , inflation or reduction in general level of economic activity is any of the entity's significant markets.

1.2 Are there any Government or Regulatory factors that might adversely affect the future financial or operating performance of the entity? (3)

Indications of potential risk include:

a) changes in accounting principles and industry specific practices that adversely affect reported profits

b) onerous or complex regulatory framework that adversely affects the entity's competitiveness

c) new legislation that adversely affects the entity's competitiveness in any of its significant markets

d) new or proposed tax legislation that adversely affects the entity's competitiveness in a significant market

1.3 Has the entity's financial or operating performance been significantly worse or better than that of the industry and/or markets in which it operates for no apparent reason?(3)

2 Nature of the entity

2.1 Are there any indications that the entity's profitability, cash flows, ability to comply with conditions in debt agreements or ability to continue trading will decline in the future? (2)

Indications of potential risk include:
a) significant downward trend in income, profit margins or liquidity;
b) possible significant bad debts;
c) short-term borrowings are being invested in long-term assets;
d) conditions in debt agreements are likely to be breached;
e) conditions imposed by regulatory authorities are likely to be breached;
f) relationships with bankers, suppliers, or investors are abrasive or deteriorating;
g) difficulties negotiating or renegotiating major contracts with customers or suppliers
h) bank facilities inadequate for future needs;
i) excessive spare productive capacity;
j) insurance cover has been reduced to inadequate levels on cost grounds;
k) increased customer dissatisfaction with products/services (evidenced by increasing product returns, warranty claims etc) or loss of key customers.
l) loss making locations
m) inability to generate positive cash flows whilst reporting profits
n) planned redundancies

2.2 Has there been a too rapid expansion in the entity's activities (4)

Indications of potential risk include:
a) uncontrolled rapid expansion in turnover;
b) entity's products/services are launched without adequate testing;
c) frequent stock-outs;
d) back orders frequently unfulfilled.

2.3 Is management aggressive in committing the entity to high risk ventures, with little or no subsequent monitoring of such risks? (3)

Indications of potential risk include:
a) management is inclined to accept high business risks;
b) there have been frequent changes in business activities;

2.4 Will the financial statements be used in connection with negotiations relating to an acquisition or disposal of a business or a segment of a business? (1)

2.5 Will the financial statements be used in connection with an earn-out or other contingent payments? (1)

2.6 Are there likely to be problems arising from new or controversial accounting policies? (3)

Indications of potential risk include: a) accounting pronouncements being applied for the first time; b) accounting policies that do not conform to the industry norm; c) changes in accounting policies other than to conform with the industry norm; d) an accounting policy followed has been described as a less preferable alternative (eg. by an accounting pronouncement or by a regulatory agency); e) an accounting policy does not comply with accounting pronouncements, generally accepted accounting principles or legal requirements. f) aggressive use of accounting policies to boost performance

3 Strategies

3.1 Is there a conflict of interest between management's private and business objectives? (2).

Indications of risk include: a) pending divorce; b) buying out a member's interest, for example because of retirement or death; c) succession issues such as introduction of children into the business; d) undue emphasis on personal tax planning; e) use of company resources as an extension of personal resources. f) personal guarantees of debts of the company g) known personal financial difficulties of managements h) possible redundancies amongst management

4 Management's characteristics

4.1 Given the size or nature of the entity, are its operating and financial decisions unduly dominated by a single person? (2)

4.2 Does management place undue emphasis on meeting budgetary, profit and other financial and operating goals? (1)

> Indications of risk include:
>
> a) management's remuneration is heavily based on operating results;
>
> b) budgets and other forecasts are unduly aggressive or clearly unrealistic;
>
> c) earning levels have been warranted;
>
> d) employees' performance is appraised in relation to budgets which are set at levels which are so unrealistically high that they encourage erroneous reporting of performance.
>
> e) profitability or trend level expectations of shareholders, significant creditors or other external parties

4.3 Does management have a poor attitude towards compliance with external or other regulatory obligations? (3)

4.4 Does management lack sufficient competence, experience or knowledge to run the business effectively? (2)

> Indications of potential risk include:
>
> a) management have too much involvement in day-to-day operations given the size of the entity;
>
> b) there have been recent changes in management;
>
> c) excessive turnover of management personnel;
>
> d) management do not have sufficient relevant experience and knowledge (including industry and market knowledge).
>
> e) Non-financial management participants excessively in selection of accounting policies or in making significant accounting judgements

4.5 Do personnel in accounting or supervisory functions lack sufficient knowledge, experience and resources to carry out their functions effectively? (2)

> Indications of potential risk include:
>
>) there are not enough trained accounting or supervisory personnel;
>
>) accounting or supervisory personnel are not of a high enough calibre;
>
>) accounting or supervisory personnel lack sufficient understanding of the entity's systems;
>
>) undue time pressure on accounting or supervisory personnel.

4.6 Are there attitude or morale problems amongst management and personnel in accounting or supervisory functions?(3)

4.7 Does management give evasive answers to our audit enquiries? (1)

4.8 Are there likely to be management imposed problems in carrying out the audit? (2)

Indications of potential risk include: a) a less than open relationship between the management and ourselves which might lead to a reluctance to provide information; b) strained relationship with auditors c) explicit limitations on scope of our audit work or attempts to influence the scope of our work d) unreasonable deadlines; e) significant subsidiaries audited by another firm of auditors or not audited f) changes in auditors for no apparent reason g) difficult working conditions; h) unusual constraints on fees; i) group entities have non-coterminous year ends; j) recent changes in advisors because of disagreements; k) unusual delays in providing information requested

4.9 Have there been significant recent allegations and/or actions brought against management or the entity by third parties or regulatory authorities? (4)

4.10 Has there been instances of missing or conflicting audit evidence in the previous years? (2)

Indications of potential risk include: a) missing documentation b) documents showing evidence alteration c) unavailability of original documentation when such documents should be available d) significant unexplained items reconciliations e) inconsistent, vague or implausible responses from management or employees arising from analytical procedures or enquiries f) unusual discrepancies between the entity’s records and confirmation replies g) unavailable or missing evidence, inconsistent with the entity’s retention policies or policies h) considerably fewer or greater numbers of responses to confirmation requests than expected

5 Operating characteristics

5.1 Does the corporate or accounting structure appear to be too complex for the entity's operations and size, taking into account its future plans: (2)

Indications of potential risk include:
a) inappropriate use of specific purpose vehicles or off-shore vehicles;
b) complex cross-holdings within a group;
c) over-complex financial arrangements;
d) substantially more subsidiary companies than are commercially necessary with a high volume of intra-group transactions;
e) use of different auditors for various group entities without a clear reason;
f) high turnover of senior management
g) frequent changes in lawyers and other advisors.
h) operating from an excessive number of locations
i) difficulty in determining controlling parties

5.2 Does the entity have active plans to raise finance or obtain business using these financial statements? (1)

5.3 Are there significant judgements involved in relation to the accounting treatment of transactions, or valuation or classification of balances and contingencies? (2)

Indications of potential risk include:
a) problems relating to the realisation of assets, contingent liabilities or other unusual uncertainties;
b) problems with timing of revenue and expenditure recognition;
c) major valuation problems such as provision for doubtful debts, obsolete or slow moving stock, overhead included in stocks, impairment of long lived assets, long term contracts;
d) asset revaluations;
e) deferral of expenditures such as development or marketing expenditure;
f) potential going-concern problems;
g) use of subjective judgements or uncertainties that are difficult to corroborate;

5.4 Are there significant difficult to audit transactions balances or events? (2)

Indications of potential risk include: a) significant transactions with affiliated entities or related parties not in the ordinary course of trade; b) lack of documentation to support major transactions, for example, because of: I) oral contracts; II) goods on consignments or sale-or-return; or III) significant cash sales. c) products being sold are subject to significant price changes; d) material royalty or other similar income; e) unusually large payments to business advisors in relation to services provided; f) complex computer processing with no visible audit trail; g) absence of up-to-date records required by regulatory authorities; h) use of business intermediaries for which there appears to be no clear commercial justification.

5.5 Are there complex underlying calculations involved in determining the amount of transactions/balances? (2)

Indications of potential risk include: a) complex leasing calculations; b) material foreign currency transactions not common to the industry c) payments or receipts based on complex formula eg royalty payments

5.6 Are material transactions or client adjustments likely to occur at or near the end of accounting periods particularly those that pose difficult substance over form questions? (2)

6 Susceptibility to misappropriation

6.1 Are any of the assets/transactions unusually susceptible to misappropriation or other manipulation? (2)

Indications of potential risk include: a) high value easily transportable fixed assets or stocks; b) high value information on computer files eg. R & D data, customer mailing lists; c) use of computerised trading eg. BACS, Electronic Data Interchange (EDI); d) large amounts of cash on hand or processed e) easily convertible assets

7 Controls

7.1 Is there a lack of sufficient information to enable management to run the business effectively? (3).

Indications of potential risk include: a) clear budget, profit and other financial and operating objectives have not been established and properly communicated to appropriate employees; b) management information is not received and acted on within a reasonable time; c) decentralisation without adequate monitoring.

7.2 Do management have a poor attitude or discipline towards controls and their enforcement? (2)

Indications of potential risk include: a) frequent override by management of laid-down control procedures; b) financial and operating objectives are not actively monitored; c) unclear or inappropriate functions or reporting relationships (including data IT functions) in relation to the size and complexity of entity; d) inadequate documentation and control procedures for authorisation and approval of transactions and system changes (including computer systems). e) ineffective accounting and information systems including inappropriate access to records by employees that are not necessary to carry out their functions f) management unwilling to correct significant internal control weaknesses that are practicable to correct; g) lack of an internal audit function where one would be expected because of the size and complexity of the entity.

7.3 Have there been any disruptions or breakdowns of accounting or information systems during the year? (1)

7.4 Are there indications that significant audit adjustments will need to be made? (2)

Indications of potential risk include: a) financial statements are prepared under excessive time pressure or other distractions; b) significant audit adjustments arising from client errors were made in prior periods; c) unexplained relationships or trends in the management accounts and the financial statements; d) transactions are not recorded in a complete or timely manner

7.5 Does management have insufficient understanding of or control over IT matters? (3)

Indications of potential risk include: a) over dependence on IT b) inadequate disaster-recovery procedures c) Abdication of IT responsibilities to contracts or outsourcers d) inadequate controls over e-business e) use of incompatible hardware and / or software f) inadequate testing of systems prior to implementation

APPENDIX 3: CONTROL STRENGTHS QUESTIONNAIRE

Information systems

1. Does management:

   a) have well defined policies and objectives (including financial objectives); and

   b) regularly monitor the entity's performance against them; and

   c) take corrective action on a timely basis?

Indications of Control Strengths include:

a) Detailed operating plans and financial targets are maintained and regularly updated

NB 1. Without these management will have nothing against which to measure actual results and hence could not detect errors and other matters requiring timely corrective action.

2. The objectives need to be reasonably set and updated as necessary, otherwise inappropriate corrective action will be taken.

b) Information systems provide sufficient relevant information at a scope and level of detail appropriate to the users of the report:

a. on a regular basis;

b. in a suitable format to enable good monitoring and control;

c. highlighting deviations from or exceptions to established targets, budgets and information.

NB: 1. Producing masses of data from which users have to extract deviations themselves will not constitute a control strength.

2. Producing reports too late to enable appropriate corrective action to be taken will not be a control strength.

c) Timely action is taken to follow up apparent anomalies, exceptional items or errors;

NB: The production of report will not in itself be a control strength unless timely corrective action is taken as necessary based on them.

d) Management ensures that exposure to business risk is kept within established limits by ensuring the assumptions in plans are set within accepted parameters.

2. Has management implemented appropriate information systems for each significant area of the business to provide accurate and timely information sufficient to make informed decisions?

Indications of control strengths include: a) all users of the system are provided with sufficient relevant information to satisfy their individual requirements; b) the formal and scope of regular reports are appropriate to the entity's business; c) on-line enquiry facilities are available and easy to use, and ad-hoc reports can be easily produced; d) accounting records are kept up-to-date e) timely exception reports are produced and reviewed.

3. Are accounting estimates appropriately reviewed and subsequently compared against actual results?

4. Does management give proper consideration to the risks associated with the acquisition and use of accounting and information systems and enforce appropriate policies and procedures for their maintenance and development (including adequate security over access to programmes and data)?

Indications of control strengths include: a) maintenance of a formal or informal IT strategy to provide guidelines within which to develop the information systems of the business; b) management is aware of the risk arising form the use of IT. c) All personnel are made aware of their responsibilities regarding security and conduct (such as the need to keep passwords secret, a ban on unauthorised copying of software, a ban on installing unapproved software on the system). d) amendments to existing systems or purchases of new software are only carried after approval by management. e) systems development personnel do not have access to live data; f) all systems under development, or shortlisted for acquisition, are reviewed for adequate controls and audit trails; g) new systems and amendments to existing systems are subjected to adequate testing and/or parallel running before implementation; h) adequate training is provided for new users, and users of a new system.

5. Does management monitor the accounting and information systems to ensure that the books of account are kept up-to-date and satisfy legislative and reporting requirements?

Indications of control strengths include: a) mechanism for monitoring and implementing changes in legislation affecting the entity's recording and reporting of financial data (eg changes in PAYE and NI); b) suspense accounts are regularly overviewed and cleared.

Supervisory procedures

6. Do management encourage a strong control environment and implementand monitor adequate controls over accounting systems?

Indications of control strengths include: a) importance of effective control procedures stressed by management; b) documentation of detailed control procedures eg in control manuals; c) extensive management review of work of subordinates; d) regular reviews of control procedures by management; e) procedures for reporting and review of control failures; f) adequate segregation of incompatible functions; g) management is responsive to suggestions from external auditors on control and information systems security matters; h) re-performance of computer processing on a sample basis.

7. Does management apply sufficiently rigorous recruitment procedures (particularly as regard taking up of references) to ensure the entity employs competent and reliable

In a small owner-managed business, one important way to reduce inherent risks is to employ honest and reliable personnel. The principal way to check up on this is to take up references from previous employers and other reputable referees. This check should be an integral part of the recruitment process.

personnel?

8. Are employee job responsibilities, reporting relationships and constraints, clearly established and communicated to employees?

9. If appropriate, are there non-executive directors or some independent body that provides enhanced control over the entity's accounting and financial reporting practices?

Indications of control strengths include: a) they have sufficient relevant experiences; b) they are provided with all relevant information and regularly attend board meetings; c) they have sufficient status and influence to be able to influence decisions of the Board of Directors.

10. If there are compliance requirements imposed by legislative or regulatory bodies or by others outside the entity, are such external requirements maintained and complied with?

APPENDIX 4: ANALYTICAL SUBSTANTIVE PROCEDURES

It is unlikely that ASPs can provide conclusive evidence about balances, although they most certainly can about transaction streams.

ASPs can be based on financial or non-financial information. In any case the base information must be reliable and we may have to check it.

ASPs have to be developed afresh for each client and an Equation Editor is provided within Audit Automation to allow you to do this for each client and carry the equations forward from year to year. Because they are largely based on identifying relationships between one piece of information and another, we need a detailed knowledge of the client and how they operate if we are to identify appropriate ratios or relationships. The following are examples of relationships which may be subjected to analytical review in certain industries:

Industry	**Item being tested**	**Some factors affecting size of item**
Auctioneers	Commission received	Sales x Commission rate
Bank	Interest received Interest paid	Average balance x days x minimum lending rate Average balance x days x minimum lending rate
Car Hire	Income Vehicle Costs	Vehicles Mileage Vehicle cost Average vehicle cost Vehicles Mileage Income Average Income
Computer	Rental income	Net leased assets
Factories	Amount of production of finished products Man-hours Machine-hours Energy consumed	Amount of raw materials used
Hire Purchase	Deposit interest	Deposit balance No. of days Base rate (Lagged)*

Industry	Item being tested	Some factors affecting size of item
Hotel	Room income Meal income	Guest/nights Room charge Occupancy rate Number of guests Average price of meal Cost of materials used Capacity of restaurant Bar sales
Insurance (analyse by class of business; also calculate solvency margin)	Provision for claims outstanding	Premiums received Claims made in past
Investment institution	Yield Management expenses	Market average Other investment companies
Laundry or Laundrette Leasing	Sales	Water used
Leasing	Rental income	No. of units leased Ruling interest rates
Mail Order	Sales Stock on approval	Despatches Despatches lagged* 1 month Returns Despatches Despatches lagged* 1 month Returns
Mining	Revenue expenditure	Tons extracted Yield rate
Newspaper	Advertising revenue Circulation revenue	Measured space price Copies (audited) Price
Periodical publishing (analyse by title)	Advertising revenue	Number of column inches of advertising Advertising rates
Professional service	Fees	Number of employees Charging rates
Property companies	Rent Receivable (The ratio of current yields borrowings to value of property should also be calculated) Expenses	Value of portfolio Date of rent review Rent receivable

Industry	**Item being tested**	**Some factors affecting size of item**
Retailer	Sales Gross profit margin	Number of employees Floor area Shelf footage Gross profit margin of other retailers of same type
Shipping	Passage money Fuel costs Seamen's wages Officers' wages Total wages	No. berths x days of cruise x fares No. special berths fares Tons fuel x price, average condemption rate miles travelled days in port Complement x pay rates
Stockbrokers	Commission	Total value of bargains Number of bargains
Transport	Revenue	Passenger/miles Ton/miles Fuel used

* Lags. In relationships involving time it is sometimes necessary to relate the figure for the item being tested (the dependent variable) for a particular month (say) to the figure for the factor (the independent variable) for an earlier month. Such a process is called 'lagging'.

APPENDIX 5: KEY INTERNAL CONTROLS

Control Objectives and examples of preventative and detective controls can be summarised as follows. Preventative controls are controls which detect on a timely basis fraud or errors which have occurred. A good control system will contain a mixture of preventative and detective controls.

Control objective	Preventative controls	Detective controls
Tangible fixed assets		
1 Existence 1.1 Balances on fixed asset accounts represent assets which exist and to which the client has proper title.	Maintenance of fixed asset register. Authorisation needed for capitalisation of expenditure.	Physical checks performed by persons independent of those keeping the fixed asset register. Regular reconciliation of fixed asset register to nominal ledger accounts.
1.2 All disposals have been properly recorded.	Authorisation procedures for all disposals (by board of directors if amounts are significant). Maintenance of fixed asset register. Controls over access to sales invoices.	Regular reconciliation of register to nominal ledger.
2 Completeness 2.1 All assets owned by the client are reflected in the accounts.	Authorisation procedures for capital purchases (by board of directors if amounts are significant). Maintenance of fixed asset register.	Physical checks performed by persons independent of those keeping the fixed asset. Regular reconciliation of register to nominal ledger.
2.2 All additions to fixed assets have been properly recorded.	Authorisation procedures for capital purchases. Maintenance of fixed asset register. Processing controls over receipts of invoices.	Regular reconciliation of register to nominal ledger. Processing controls over recording of additions.
3 Accuracy 3.1 Additions/disposals have been recorded in the correct period.	Maintenance of fixed asset register. End of period controls over purchases.	Reconciliation of fixed asset register to nominal ledger accounts.
3.2 Castings/extensions in fixed asset accounts are correct.	Use of control accounts.	Reconciliation of fixed asset register to nominal ledger accounts.
4 Valuation 4.1 Assets are valued correctly on an acceptable basis.	Processing controls to ensure cost is correctly recorded.	Reconciliation of fixed asset register to nominal ledger accounts.

Control objective	Preventative controls	Detective controls
	Review procedures for obsolescence etc of fixed assets. Revaluation (if any) performed by competent persons.	
4.2 Depreciation has been properly charged.	Review procedures for determining estimates of useful lives. Depreciation of each asset recorded in the asset register.	Reconciliation of depreciation charges in nominal ledger accounts to totals in fixed asset register. Investigation into assets either held at nil net book value or not depreciated.
4.3 Provision has been made for permanent diminution in value where appropriate.	Regular review procedures for obsolescence etc.	
5 Presentation and Disclosure 5.1 Assets are appropriately classified.	Fixed asset register analysed into appropriate headings.	Regular trial balance, management accounts.
Stocks and work-in-progress		
1 Existence 1.1 Quantities properly represent products, materials and consumables to which the company has title.	Stores areas segregated and locked. Stock records segregated from stores. Serially numbered requisitions or other control of usage.	Regular checks on physical quantities and investigation of differences between book and actual.
1.2 Charges or other restrictions on the free disposal of stocks are identified.		
2 Completeness 2.1 All products materials and consumables to which the company has title, wherever situated, are reflected in the quantities recorded.	Stock records segregated from stores. Serially numbered documents for all stock movements. Control over stocks at outside locations.	
3 Existence 3.1 Quantities properly represent products, materials and consumables to which the company has title.	Stores areas segregated and locked. Stock records segregated from stores. Serially numbered requisitions or other control of usage.	Regular checks on physical quantities and investigation of differences between book and actual.
3.2 Charges or other restrictions on the free disposal of stocks are identified.		
4 Completeness 4.1 All products materials and consumables to which the company has title, wherever	Stock records segregated from stores. Serially numbered documents for all stock movements.	

Control objective	Preventative controls	Detective controls
situated, are reflected in the quantities recorded.	Control over stocks at outside locations.	
5 Accuracy 5.1 Quantities are counted and recorded correctly.	Stock records segregated from stores. Adequate instructions for annual or periodic counts.	Independent and reconciliation of actual to book stocks and investigation of differences.
5.2 Records of stock counted are properly summarised and incorporated in the financial statements.	Pre-numbered count sheets or tags. Control of count sheets segregated from personnel performing the count.	Independent review of completeness of summaries.
5.3 Cost of stocks accurately represents costs of bringing it to present condition and location.	Stock records show cost of goods purchased. Consistent valuation of work in progress.	Independent review of standard costs, variances, where appropriate.
6 Valuation		
6.1 Appropriate provision is made for excess, slow-moving, obsolete or defective items.		Stock usage regularly reviewed to identify such items.
6.2 Long-term contract work in progress is valued on an appropriate basis.	Maintenance of contract records independent of stores.	Checks on completeness of documentation for contract costs.
		Independent review of profit taken, loss expected.
Debtors, sales and receipts		
1 Existence 1.1 All sales recorded are supported by despatches.	Pre-numbered invoices, with unused invoices controlled. Monthly statements sent to customers. Invoices matched to despatch documents.	Invoices reconciled to despatch notes and approved sales orders. Investigation of overdue debtors. Independent review and follow-up of unmatched invoices.
2 Completeness 2.1 All goods and services supplied are invoiced.	Pre-numbered despatch notes, matched to invoices. Checking of despatch documents before goods may leave premises. Invoicing is independent of despatch and stock control department. Control over non-routine sales.	Despatches are reconciled to invoiced quantities. Independent review and follow-up of unmatched despatch documents.
2.2 All sales invoices are recorded.	Matching of despatches, orders to invoicing totals (daily, weekly) and invoicing total taken straight to posting source.	Invoicing total reconciled independently to total posting to debtors ledger.
2.3 All cash receipts are	Monthly statements sent to customers,	Regular review of aged debtors

Control objective	Preventative controls	Detective controls
deposited and recorded.	independently of debtors ledger clerks. Handling of cash receipts segregated from debtors ledger. Control over incoming cash (eg post opened and cheques listed independently of cashiers, pre- numbered receipts used for sales in cash.	and independent follow-up of overdue accounts. Sequence of pre-numbered receipts checked independently.
3 Accuracy 3.1 Sales are recorded in the correct period.	Pre-numbered invoices and despatch notes. Control over last despatches, movements of finished goods during stock count.	Independent reconciliation of sales recorded in debtors ledger to despatches. Independent reconciliation of stock count figures to despatch records.
3.2 Posting/additions in debtors ledger are correct.	Validation checks. Batch posting controls. Procedures to ensure re-submission of rejected items after correction and resolution of items posted to suspense.	Regular reconciliation of control account to sub- ledger. Regular trial balance. Prompt investigation of differences.
3.3 Invoices are for the correct amount.	Standard price list/trade discounts. Prices approval required for any exception to price list.	Independent check of prices, extensions etc. Investigation of overdue and credit balances. Independent follow-up of customer queries and complaints.
3.4 Returns and other allowances and to customers are approved and recorded correctly.	Pre-numbered credit notes. Prior approval of credits to customers, independent of debtors ledger. Independent authorisation of bad debt write-off. Cashier function segregated from debtors ledger. All receipts are banked promptly. Listing of cheques before deposit.	Independent review of non- cash credits in debtors ledger.
3.5 Receipts recorded equal deposits.	Cashier function segregated from debtors ledger. All receipts are banked promptly. Listing of cheques before deposit.	Regular bank reconciliation's, reviewed independently. Review of aged debtors. Follow-up of customer complainants.
4 Valuation 4.1 Uncollectable accounts are	Credit references taken before accepting	Regular independent review of

Control objective	Preventative controls	Detective controls
promptly identified and appropriate provision made.	orders. Credit limits established. Periodic review of credit limits.	aged debtors. Investigation of overdue accounts.
5 Presentation and Disclosure 5.1 Sales and debtors are classified correctly.	Ledger analysed into appropriate types of sale.	Regular trial balance.
Creditors, purchases and payments		
1 Existence 1.1 Liabilities recorded reflect goods or services received, and are in respect of the business `	Proper authorisation of purchases. Receiving dept segregated from creditors ledger, stock records and purchasing department. Pre-numbered purchase orders. Goods received note matched to invoice. Adequate inspection of goods for shortages etc. Invoices cancelled to prevent reprocessing. Goods received notes and invoices sent directly to accounts, not purchasing department.	Purchase invoices checked to orders, goods received notes. Unmatched invoices investigated independently.
2 Completeness 2.1 All liabilities incurred are recorded.	Pre-numbered goods received notes. Separation of purchasing creditors ledger and stock records from receiving department. Controls over direct deliveries from supplier to customer.	Independent reconciliation of suppliers statements. Sequence of pre-numbered good received notes checked independently of receiving dept. Goods received notes matched to purchases recorded.
3 Accuracy 3.1 Liabilities recorded in correct period.	Pre-numbered goods received notes. Control over last despatches movements of stocks during stock count.	Independent reconciliation of stock count figures to stores records.
3.2 Posting/additions in creditors ledger are correct.	Validation checks. Batch posting controls. Use of control accounts. Procedures to ensure re-submission of rejected items after correction and resolution of items posted to suspense.	Regular reconciliation of control account to sub- ledger. Regular trial balance. Prompt investigation of differences.
3.3 Amount of purchase/liability recorded correctly.	Batch posting controls. Check of additions, extension on invoice before posting.	Independent reconciliation of suppliers statements.
3.4 Amount of payment recorded	Segregation of cash function from creditors	Independent reconciliation of

Control objective	Preventative controls	Detective controls
correctly.	ledger.	suppliers statements.
4 Presentation and Disclosure 4.1 Purchases and creditors are classified correctly.	Ledger analysed into appropriate types of purchase.	Regular trial balance, management accounts.
Wages and salaries		
1 Existence 1.1 Payroll cannot be inflated by fictitious employees.	Segregation of personnel and payroll functions. Written notification of starters, leavers to payroll. Employee identification when pay is distributed. Control over unclaimed pay. Cheque preparation segregated from signing and from distribution of payroll. Independent review of payroll before distribution is begun.	Independent comparison and reconciliation of payroll with prior or 'standard' payroll. Independent bank reconciliation and check of payroll cash withdrawals against payroll records.
1.2 Employees cannot be paid for work not done.	Use of time cards or time reports and their approval. Control/supervision over clocking on and off. Approval of piece work tickets by foremen. Authorisation of overtime.	Salesmen commissions checked to sales records.
2 Completeness 2.1 Nominal ledger includes all amounts relating to payroll.	Control accounts maintained for wages, salaries and all deductions. Direct posting of net pay to nominal ledger with journal entries to control accounts.	Regular reconciliation and clearance of wages and salaries control accounts.
3 Accuracy 3.1 Gross pay and deductions are correctly calculated.	Payroll department notified in writing of additions, termination's, rate changes. Written authority for all non-standard and voluntary deductions.	Independent comparison and reconciliation of payroll with prior or 'standard' payroll.

APPENDIX 6: LINKAGE OF ISAs AND ETHICAL STANDARDS TO AUDIT PACKS

ISA Ref	ISA requirement	How dealt with by Master Packs and software controls	Other controls and comments
200.14	Ethical requirements		Dealt with in audit Policies Manual and Firm's own policies
200.15	Professional scepticism		Firm's training and procedures
200.16	Professional judgment		Firm's training and procedures
200.17	Sufficient appropriate audit evidence and audit risk		Built in throughout master packs
200.18-20	Compliance with ISAs		Built in throughout master packs and Firm's training and procedures
200.21	ISA Objectives		Built in throughout master packs and Firm's training and procedures
200.22-23	Compliance with ISA Objectives		Built in throughout master packs and Firm's training and procedures
200.24	Failure to achieve an objective		Firm's procedures
210.6	Preconditions for an audit		Audit Policies Manual. Engagement Letter
210.7	Imposed limitation on scope		Audit Policies Manual Parts 4.2.5 and 4.4.1
210.7	Other factors affecting audit engagement acceptance		Audit Policies Manual Part 4
210.10	Agreement on engagement terms	Pre planning Checklist	
210.13	Recurring Audits	Pre Planning Checklist	
210.14	Acceptance of change in terms of an audit engagement	Re-appointment acceptance Checklist	Firm's policies
210.18	Additional considerations in engagement acceptance		It is assumed that all audits will be of financial statements in accordance with IFRS or UK GAAP and all reports will be under UK jurisdiction, so this will not be an issue
220.	Leadership Responsibilities for Quality on Audits		Audit Policies Manual and Firm's procedures
220.9-11	Relevant Ethical requirements incl Independence	Re-appointment Acceptance Checklist	Audit Policies Manual and Firm's procedures
220.12-13	Acceptance and continuance of client relationships and audit engagements	Re-appointment Acceptance Checklist	
220.14	Assignment of engagement teams	Audit Planning Checklist	Firm's procedures
220.15	Direction, supervision and performance	Senior Review Checklist, Manager Review Checklist and Senior Statutory Auditor Review Checklist	Firm's procedures
220.16-17	Reviews	Senior Review Checklist, Manager	Firm's procedures

		Review Checklist and Senior Statutory Auditor Review Checklist	
220.18	Consultation	Senior Review Checklist, Manager Review Checklist and Senior Statutory Auditor Review Checklist	Firm’s procedures
220.19-21	Engagement Quality Control	Independent review planning checklist, Senior Statutory auditor review Checklist and Second Partner Review Checklist	Audit Policies Manual and Firm’s procedures
220.22	Differences of opinion		Audit Policies Manual and Firm’s procedures
220.23	Monitoring		Firm’s procedures
220.24	Documentation of ethical matters	Pre-planning checklist, Independent Review Planning Checklist, Senior Statutory Auditor Review Checklist and Second Partner Review Checklist	
220.25	Documentation of engagement quality control review	Second Partner Review Checklist	
230.7	Timely preparation of audit documentation		Firm’s procedures
230.8-11	Form, content and extent of audit documentation	Controls within software	
230.12	Departure from a relevant requirement		Firm’s procedures
230.13	Matters arising after date of the auditor’s report		Firm’s procedures
230.14	Assembly of the final audit file	Controls within software	Firm’s procedures
240.12-14	Professional scepticism		Firm’s training and procedures
240.15	Engagement team discussion of fraud risk	Audit Planning Checklist	
240.16-21	Inquiries of management and those charged with governance re fraud	Understanding the client’s business checklist	
240.22	Indications of fraud risk from analytical review procedures	Audit planning checklist and Preliminary Analytical review	
240.23	Indications of fraud risk from other information	Audit Planning Checklist	
240.24	Evaluation of fraud risk factors	Audit Planning Checklist	
240.25-27	Identification and assessment of the risks of material misstatement due to fraud	See comments on ISA315	
240.28-33	Responses to assessed risk of material misstatement due to fraud	See comments on ISA 330	
240.31-33	Audit procedures responsive to risks related to management override of controls	Journals: Audit Programme for Trial Balance and Accounts Estimates: pool of tests Related Parties: Related Parties Programme and Pool of tests Controls: Understanding the Client’s Business Checklist and Pool	

		of Tests	
240.33.1-37	Evaluation of audit evidence	Overall Review of Financial Statements Programme, Audit Senior Review Checklist, Manager Review Checklist, Senior Statutory Auditor review Checklist	
240.38	Auditor unable to continue the engagement		Firm's procedures
240.39	Written representations	Audit Senior Review Checklist, Manager Review Checklist and Senior Statutory Auditor Review Checklist	Audit Policies
240.40	Communication to management and with those charged with governance	Audit Senior Review Checklist, Manager Review Checklist and Senior Statutory Auditor Review Checklist	
240.43	Communications to regulatory and enforcement authorities	Audit Senior Review Checklist, Manager Review Checklist and Senior Statutory Auditor Review Checklist	Firm's procedures re reports to MLRO
250A.13-18 &30	Consideration of compliance with laws and regulations and documentation	Permanent File review Programme, Understanding the Clients Business Checklist and Audit Planning Checklist	
250A.19-22	Procedures when non-compliance is identified or suspected	Liabilities and Charges Audit Programme	Firm's Procedures
250A.23-25	Reporting non-compliance to those charged with governance	Management Letter Review	
250A.26-28	Reporting non-compliance in auditor's report	Senior Statutory Auditors Review Checklist	Firm's Procedures
250A.29	Reporting non-compliance to regulatory and enforcement authorities		Firm's Procedures
250B	Public Entities		Not specifically covered
260.11-13	Determining who to communicate with	Assumes communication is with management	Firm's procedures
260.14	Communication of auditor's responsibilities	Audit Planning Checklist	Engagement Letter
260.15	Communication of planned scope and timing of the audit	Audit Planning Checklist	
260.16	Communication of significant findings from the audit	Management Letter Review and Senior Statutory Auditors Review Checklist	
260.17	Communication of auditor independence	Applies to listed companies only and not specifically covered	
260.18	Establishing the communication process		Firm's procedures
260.19-20	Forms of communication	See above	
260.21	Timing of communication		Firm's procedures
260.22	Adequacy of communication process		Firm's procedures

260.22	Documentation	Audit Planning Checklist Senior Statutory Auditors Review Checklist	
265.7-11	Communication of deficiencies in internal control	Management Letter Review	
300.5	Involvement of key engagement team members		Firm's procedures
300.6	Preliminary engagement activities	See ISA 220 above and	
300.7-9	Establish an overall audit strategy	Audit Planning Checklist	
300.10	Update and change strategy as necessary		Firm's Procedures
300.11	Plan nature, timing and extent of direction and supervision	Audit Planning Checklist	
300.12	Planning documentation	Audit Planning Checklist	
300.13	Planning an initial audit engagement		Covered by Firm's Procedures and running a client for the first time
315.13-16	Risk assessment procedures and related activities	Inherent Risk questions, Understanding the Client's Business Checklist, Preliminary Analytical Review, Identified Risks module.	Details are set out in the procedures manual.
315.17-18	Team discussion of risk of material misstatement	Audit Planning Checklist	Details are set out in the procedures manual.
315.19-20	Understanding the Entity and its Environment, the Applicable Financial Reporting Framework and the Entity's System of Internal Control	Understanding the Client's Business Checklist	Details are set out in the procedures manual.
315.21-27	Understanding the Components of the Entity's System of Internal Control	Understanding the Client's Business Checklist, Control Strengths Checklist, Controls Evaluation Checklist, General IT Risks Checklist and Permanent File Review Checklist	Details are set out in the procedures manual.
315.28-34	Identifying and Assessing the Risks of Material Misstatement	As above together with Audit Planning Checklist and use of Identified Risks module	Details are set out in the procedures manual.
315.35-37	Stand-back procedures	Audit Planning Checklist and use of Identified Risks module	Details are set out in the procedures manual.
315.38	Documentation of risk assessment	Audit Planning Checklist	
320.10-11	Determining materiality and performance materiality at planning stage	Audit Planning Checklist; Materiality calculator	
320.12-13	Revision of materiality and performance materiality during audit	Audit Programmes	Firm's Procedures
320.14	Documentation of materiality and performance materiality	Audit Planning Checklist; Materiality calculator	
330.5	Responses to assessed risk of material misstatement at	Audit Planning Checklist	

	financial statement level		
330.6-7	Design of audit procedures responsive to assessed risks of material misstatement at the assertion level	Audit Planning Checklist	Tailoring of Audit Programmes
330.8-17	Design and performance of tests of control where reliance is placed on their effectiveness	Pool of Tests	
330.18-23	Design of substantive procedures responsive to assessed risks	Audit Programmes and Pool of Tests	
330.24	Audit procedures to evaluate adequacy of presentation and disclosure	Disclosure Checklists	
330.25-28	Evaluation of the sufficiency and appropriateness of audit evidence	Audit Senior Review Checklist, Manager Review Checklist and Senior Statutory Auditor Review Checklist	
402.9-14	Understanding the services provided by a service organisation	Using a Service Organisation Checklist	
402.15-16	Responding to assessed risks of material misstatement	Using a Service Organisation Checklist	
402.17-18	Using Type 1 and 2 Reports	Using a Service Organisation Checklist	
402.19	Fraud, Non-Compliance with Laws and Regulations and Uncorrected Misstatements	Using a Service Organisation Checklist	
402.20-22	Modification of auditor's report	See ISA 705	
450.5	Accumulation of identified misstatements	Audit Programmes	
450.6	Effect of misstatements on audit strategy		Firm's Procedures
450.7	Additional work where management correct detected misstatements		Firm's Procedures
450.8-9	Communication and correction of misstatements		Firm's Procedures
450.10-11	Evaluating the effect of uncorrected misstatements		Firm's Procedures
450.12-13	Communicating uncorrected errors to those charged with governance		Audit Policies Manual
450.14	Written representations re uncorrected errors	Compliance with ISAs Checklist	Audit Policies Manual
500.6	Sufficient appropriate audit evidence	Audit Senior Review Checklist, Manager Review Checklist and Senior Statutory Auditor Review Checklist	
500.7-9	Information to be used as audit evidence		Firm's Procedures
500.10	Selection of test items		Firm's procedures

500.11	Inconsistency in, or doubts over reliability of, audit evidence		Firm's Procedures
501.4-8	Audit evidence re material stock	Stock Audit Programme	
501.9-12	Audit evidence re litigation and claims (including written representations)	Liabilities and Charges Programme	
501.13	Audit evidence re segment information	Disclosure Checklists	
505.7	External confirmation procedures		Firm's procedures
505.8-9	Management's refusal to allow a confirmation request to be sent		Firm's procedures
505.10-11	Reliability of responses to confirmation requests		Firm's procedures
505.12	Non-responses to requests		Firm's procedures
505.13	Exceptions		Firm's procedures
505.15	Negative confirmations		Firm's procedures
505.16	Evaluating the evidence obtained		Firm's procedures
510.5-6	Obtain evidence about whether opening balances contain material misstatements that materially affect current period's financial statements (including reading most recent financial statements)	Trial Balance and Accounts Programme	
510.7	If misstatements detected in opening balances, perform additional procedures	Trial Balance and Accounts Programme	
510.8-9	Consistency of accounting policies	Overall Review of Financial Statements	
510.10-11	If insufficient appropriate audit evidence re opening balances, qualify audit opinion accordingly		Firm's procedures
510.12	If inconsistent accounting policies, qualify audit opinion appropriately		Firm's procedures
520.5	Design and performance of substantive analytical procedures	Pool of Tests	
520.6	Use of analytical procedures to assist when forming an overall conclusion	Overall Review of Financial Statements	
520.7	Investigating results of analytical procedures		Firm's procedures
530.6-8	Sample design, size and selection of items for testing	Sampling Plan	

530.9-10	Perform audit procedures on selected items unless procedure not applicable to item		Firm's procedures
530.11	Treat items that designed procedures or suitable alternative procedures cannot be performed on as deviations/misstatements		Firm's procedures
530.12	Investigate nature and cause of deviations/misstatements	Audit Programmes	
530.13	If deviation/misstatement considered to be an anomaly, carry out additional procedures to prove this	Audit Programmes	
530.14	Project misstatements to population	Audit Programmes	
530.15	Evaluate results of audit sampling		Firm's procedures
540.13	As part of risk assessment, obtain an understanding of how management identifies need for accounting estimates and makes them	Understanding Client's Business Checklist	
540.14	Evaluate outcome of accounting estimates made in prior period, or where applicable their re- estimation this period	Overall Review of Financial Statements	
540.15	Determine whether the engagement team requires specialized skills or knowledge	Audit Planning Checklist and Pre-planning checklist	
540.16	Evaluate degree of estimation uncertainty associated with an accounting estimate as part of risk assessment	Audit Planning Checklist and Identified Risks module	Audit procedures manual sets out approach
540.17	Consider whether any risks from accounting estimates are significant risks	Audit Planning Checklist and Identified Risks module	Audit procedures manual sets out approach
540.18	Carry out procedures including one at least from (a) audit evidence from post balance sheet events; (b) Testing how management made the estimate; or (c) Developing an auditor's point estimate or range	Overall Review of Financial Statements	
540.19	Test the operating effectiveness of relevant controls where appropriate.	Part of Identified Risks module	Audit procedures manual sets out approach
542.20	For accounting estimates that give rise to significant risks, and controls are not tested, tests of detail must be included.		Audit procedures manual sets out requirement
540.21	Obtaining Audit Evidence from	Subsequent events review; Overall	

	Events Occurring up to the Date of the Auditor's Report	Review of Financial Statements	
540.22-27	Testing How Management Made the Accounting Estimate	Overall Review of Financial Statements	
540.28-30	Developing an Auditor's Point Estimate or Range		Firm's procedures
540.31	Disclosures related to accounting estimates	Disclosure Checklists	
540.32	Review judgments and decisions made by management in relation to accounting estimates for possible management bias	Overall Review of Financial Statements	
540.33-34	Overall Evaluation Based on Audit Procedures Performed	Overall Review of Financial Statements	
540.35-36	Determining Whether the Accounting Estimates are Reasonable or Misstated	Overall Review of Financial Statements	
540.37	Obtain written representations re accounting estimates	Overall Review of Financial Statements	Audit Policies Manual and procedures manual
540.37	Communication to client	Management letter review	Audit Policies Manual and procedures manual
540.38	Documentation	Overall Review of Financial Statements	
550.11 & 28	Overall requirements and documentation	Planning checklist, Related Party Transactions Programme, Review checklists	
550.12	Engagement team discussion to include risk of material misstatement resulting from related party relationships and transactions	Audit Planning Checklist	
550.13	Obtaining details of related party relationships and transactions from management	Understanding Clients Business Checklist	
550.14	Obtaining an understanding of controls to identify, authorize and approve, account for and disclose related party relationships and controls and significant transactions and arrangements outside the normal course of business	Understanding Clients Business Checklist	
550.15	Maintaining alertness for related party information when reviewing records or documents	Audit Programmes for Debtors, Sales, Creditors, Purchases	
550.17	Sharing related party information with the engagement team	Related Party Transactions Programme	
550.18-12	Identification and assessment of the risks of material misstatement associated with related party relationships and transactions, with planned	Audit Planning Checklist And Identified Risks mocule	

	responses		
550.21-22	If previously unidentified or undisclosed related parties or significant related party transactions are identified, communicate with audit team, request further information from management and perform appropriate additional procedures	Related Party Transactions Programme	
550.23	For identified significant related party transactions outside the entity's normal course of business, evaluate their appropriateness	Related Party Transactions Programme	
550.24	Obtain evidence to support assertions that related party transactions were conducted at arm's length	Related Party Transactions Programme	
550.25	Evaluate accounting for and disclosure of identified related party relationships and transactions	Disclosure Checklists	
550.26	Obtain written representations concerning accounting for and disclosure of related party transactions	Representations included in review checklists for senior, manager and partner	Audit Policy Manual
550.27	Communication of significant matters arising from audit of related parties to those charged with governance	Management Letter Review	
560.6-7	Perform procedures to obtain sufficient appropriate audit evidence regarding events occurring between the date of the financial statements and the date of the auditors report including understanding management's procedures to identify events, making inquiries of management, and reading minutes and interim accounts	Subsequent Events Review	
560.8	Determine whether events identified are appropriately reflected in the financial statements	Subsequent Events Review	
560.9	Obtain written representations concerning subsequent events	Compliance with ISAs Checklist	Audit Policy Manual
560.10-13	Facts which become known to the auditor after date of auditor's report but before the financial statements are issued		Firm's Procedures
560.14	Facts which become known after financial statements issued		Firm's Procedures
570.10	Assess risk of going concern as	Audit Planning Checklist	

	part of risk assessment procedures		
570.11	Remain alert to events that may cast doubt on going concern throughout audit	Going Concern Review	Firm's procedures
570.12-14	Evaluate management's assessment of going concern for at least 12 months after date of approval of financial statements	Going Concern Review	
570.15	Inquire of management of any knowledge of going concern issues beyond period of management's estimate	Going Concern Review	
570.16	UK Corporate Governance Code Reporting	Not covered	
570.17-18	Where going concern issues are identified, perform additional procedures	Going Concern Review	
570.19-20	Disclosures Related to Going Concern	Going Concern Review	
570.21-24	Conclude on going concern and include concerns in audit report as appropriate, including where period of management's estimate is less than period required by auditors	Senior Statutory Auditor Review Checklist	Firm's procedures
570.25	Communication of significant matters arising from audit of going concern to those charged with governance	Management Letter Review	
570.26	Consider reasons for significant delay in the approval of financial statements		Firm's Procedures
580.9	Request representations from appropriate management		Firm's Procedures
580.10-13	Obtain representations about responsibility for preparation of financial statements, information provided and completeness of transactions and specific matters	Management Letter Review and ISA Compliance Checklist	
580.14	Date of and periods covered by written representations		Audit Policies Manual
580.15	Form of written representations		Audit Policies Manual
580.16-20	Doubt as to the reliability of written representations and requested written representations not provided, and auditor's response		Firm's Procedures
600.11	Group Engagement Partner responsible for direction	Planning of Group audit	

	supervision, and performance of group audit		
600.12	Consider acceptance and continuance including obtaining understanding of the group, its components and their environment and evaluating involvement where component auditors	Group pre Planning Checklist	
600.13	Refuse appointment where significant imposed limitations on scope	Re-appointment acceptance Checklist	
600.14	Agree terms of group engagement	Group pre-planning Checklist and Re- appointment acceptance Checklist	
600.15-16	Establish overall audit strategy and audit plan and review by group engagement partner	Planning of Group Audit Checklist	
600.17-18	Understanding the group, its components and their environments, including group- wide controls and consolidation process	Permanent File Review, Group pre-planning Checklist and Planning of Group Audit Checklist	
600.19	Understanding the component auditor	Group Planning Checklist	
600.20	Determine materiality for group as a whole, specific materiality, component materiality and threshold where misstatements cannot be regarded as trivial	Group Planning Checklist	
600.22-23	Evaluate appropriateness of performance materiality used by component auditors	Group Planning Checklist	
600.24-25	Responding to assessed risks	Group Planning Checklist	
600.26-29	Determining type of work to be performed on financial information of components	Group Planning Checklist	
600.30	Involvement in the risk assessment work performed by component auditors	Group Planning Checklist	
600.31	Evaluating the appropriateness of further audit procedures to be performed by component auditors and determining further involvement	Group Planning Checklist	
600.32-37	Design and performance of work on consolidation process including consistency of accounting policies	Consolidation Procedures Programme	
600.38-39	Consideration of subsequent events in the group context	Group Subsequent Events Review	
600.40	Communication with the component auditor covering co- operation, ethics,	Group Planning Checklist	Firm’s Procedures

	materiality, significant risks, and related parties		
600.41	Communication from component auditors re compliance with instructions and audit findings	Consolidation procedures Programme and	
600.42-43	Evaluating the component auditor's communication and adequacy of their work	Group Audit Review Checklists and Review of Component Auditors Working Paper Files	
600.44-45	Sufficiency and appropriateness of audit evidence including consideration of uncorrected misstatements	Group Audit Review Checklists	
600.46-48	Communication with group management re deficiencies in group-wide and component internal controls and fraud identified	Group Management Letter Review	
600.49	Communication with those charged with governance of overview of work to be performed on components financial information, involvement of group engagement team and component auditors, concerns over work of component auditors, limitations on the group audit, and fraud or suspected fraud involving management and senior employees	Group Planning Checklist	Firm's Procedures
610.15-20	Determining whether and to what extent to use the work of the internal auditors	Work of Internal Audit Programme	
610.21-25	Using specific work of the internal auditors	Work of Internal Audit Programme	
610.26-35	Using Internal Auditors to Provide Direct Assistance	Work of Internal Audit Programme	
620.7	Determining the need for an expert	Independent Expert Programme	
620.8	Nature, timing and extent of audit procedures	Independent Expert Programme	
620.9	Evaluating the competence, capabilities and objectivity of the expert	Independent Expert Programme	
620.10	Obtaining an understanding of the field of expertise of the expert	Independent Expert Programme	
620.11	Agreement of terms with the expert	Independent Expert Programme	
620.12-13	Evaluating the adequacy of the expert's work	Independent Expert Programme	
620.14-15	Reference to the expert in the		Firm's Procedures and policies

	auditor's report		
700.10-15	Forming an opinion on the financial statements	Senior Statutory Auditor Review Checklist	Firm's Procedures and policies
700.16-19	Forms of opinion	Senior Statutory Auditor Review Checklist	Firm's Procedures and policies
700.20-52	Audit report	Senior Statutory Auditor Review Checklist	Firm's Procedures and policies
700.53-54	Supplementary information	Senior Statutory Auditor Review Checklist	Firm's Procedures and policies
701.9-18	Communicating Key Audit Matters in the Audit Report	Senior Statutory Auditor Review Checklist	Firm's Procedures and policies
705.6	Circumstances when a modification to the auditor's opinion is required	Senior Statutory Auditor Review Checklist	Firm's Procedures and policies
705.7-15	Determining the type of modification in the auditor's opinion	Senior Statutory Auditor Review Checklist	Firm's Procedures and policies
705.16-29	Form and content of auditor's report when opinion is modified	Senior Statutory Auditor Review Checklist	Firm's Procedures and policies
705.30	Communication with those charged with governance	Management Letter Review	
706.8-9	Emphasis of Matter paragraphs in auditor's reports	Senior Statutory Auditor Review Checklist	Firm's Procedures and policies
706.10-11	Other matter paragraphs in the auditor's report	Senior Statutory Auditor Review Checklist	Firm's Procedures and policies
706.12	Communication with those charged with governance	Management Letter Review	
710.6	Classification of comparative information	Overall Review of Financial Statements	
710.7-8	Carrying out additional procedures on comparative information if apparent misstatement in it	Overall Review of Financial Statements	
710.9	Written representations re restatement of comparatives	Audit Review Checklist	
710.10-12	Effect of modifications in prior period auditor's report		Firm's Procedures and policies
710.13	Procedures where prior period audited by predecessor auditor		Firm's Procedures and policies
710.14	Procedures where prior period not audited		Firm's Procedures and policies
720.12	The auditor's responsibilities relating to other information - understanding the entity	See ISA 315 requirements - planning	
720.13-15	Obtaining and assessing the Other Information shown in the financial statements	Overall Review of Financial Statements and Senior Statutory Auditor Review Checklist	
720.16-20	Responding to inconsistencies	Senior Statutory Auditor Review Checklist	Firm's Procedures and policies

720.21-24	Form of report	Senior Statutory Auditor Review Checklist	Firm's Procedures and policies

ES Ref	Ethical standard requirement	How dealt with by Master Packs and software controls	Other controls and comments
Part A and B1	Overarching principles and supporting ethical Provisions; General requirements	Reappointment and Pre-planning checklists require a consideration of threats to integrity, objectivity and independence together with the required responses, including EQCR and second partner reviews. EQCR and second partner review requirements and documentation are covered in their respective checklists.	Dealt with in audit Policies Manual and Firm's own policies
B2	Financial, business, employment and personal relationships	Reappointment and Pre-planning checklists deal with restrictions	Dealt with in audit Policies Manual and Firm's own policies
B3	Long association with engagements and with entities relevant to engagements	Reappointment and Pre-planning checklists deal with restrictions	Dealt with in audit Policies Manual and Firm's own policies
B4	Fees, remuneration and evaluation policies, gifts and hospitality, litigation	Reappointment and Pre-planning checklists deal with restrictions	Dealt with in audit Policies Manual and Firm's own policies
B5	Non-audit / additional services	Reappointment and Pre-planning checklists require a consideration of the extent of non-audit services and informed management	Dealt with in audit Policies Manual and Firm's own policies
B6	Provisions available for audits of small entities	Reappointment and Pre-planning checklists deal with restrictions and requirements.	Dealt with in audit Policies Manual and Firm's own policies

APPENDIX 7: WHATS CHANGED

Changes to Audit Automation packs - September 2022

<u>Changes to all audit packs apart from pensions (see separate section for IPEN11)</u>
IFULL13 (creating IFULL14)
CCHCH14 (creating CCHCH15)
IGROUP13 (creating IGROUP14)
CCHLLP12 (creating CCHLLP13)

Audit planning checklist
Added question for stand-back procedures (does not apply to Group pack).

Main index
This has been thoroughly updated.

Assertions
The CCH Audit Procedures manual has never included assertion BL 'Classification', which some other methodologies also do not show separately for practical purposes. Although BL was listed in most audit packs, there were almost no tests linked to it. Similarly, assertion TD 'Classification' had almost no tests linked to it.

In practice, these classification assertions (which assert that the balance/transaction was recorded in the proper account) are reviewed and tested as part of any review or test of valuation/accuracy. ISA 315 (para A189) permits the combination of assertions so long as all the elements are retained. Therefore, the assertions in the main audit packs have been simplified as follows.

- Removed assertions BL 'Classification' and TD 'Classification'
- Amended assertion BV to be 'Valuation and classification'
- Amended assertion TA to be 'Accuracy and classification'

In addition, a new assertion ZZ for Risks 'pervasive to the financial statements as a whole' was added and is available in sections A and Y

Audit areas
Assertions included in the audit areas were not consistent between entities. Some areas have been amended as follows:

- A Audit and accounts review - now only has the presentation and pervasive assertions PD, ZZ
- S Profit and loss - wrongly had balance instead of transaction assertions; now changed
- Y Trial balance and accounts - now also includes the balance assertions BV, BC, BE plus ZZ

Pool tests

- These have been amended for the change of assertions set out above
- Analytical tests were added to section S - Profit and Loss (Company and LLP packs)

1.3
<u>Summary of changes to IPEN10 master pack (creating IPEN11)</u>

Audit planning checklist
Added question for stand-back procedures.

Assertions
A new assertion ZZ for Risks pervasive to the financial statements as a whole was added and is

available in sections A and Y.

Note that the classification assertion TD is used extensively in relation to the specific requirements of pensions and therefore this has been retained for the pensions audit pack.

Audit areas
Two areas have been amended as follows:

- A Audit and accounts review - now only has the presentation and pervasive assertions PD, ZZ
- Y Trial balance and accounts - now also includes the balance assertions BV, BC, BE plus ZZ

Main index
This has been thoroughly updated.