ACCA audit monitoring reviews – quarterly update – common audit issues in audit planning

This quarter we are focusing on some common audit issues that we come across in our audit monitoring reviews during the audit planning stage, and how firms should look to address them. This article focuses on the following three areas, and what practitioners should be considering for each:

1 **Audit sampling** – have you explained the basis on how samples are picked, and are the sample sizes big enough?

2 **Walkthroughs** – have you documented your understanding of the design and implementation of internal controls, even when taking a fully substantive approach to the audit?

3 **Analytical procedures** – are you using analytical procedures to gain an understanding of the client's operations as well as flagging potential risks of material misstatements?

AUDIT SAMPLING

International Standard on Auditing (UK) 530 (updated May 2022) applies when the auditor has decided to use audit sampling in performing audit procedures to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the auditor's opinion under ISA 500. It deals with the auditor's use of statistical and non-statistical sampling when calculating and selecting the audit sample and evaluating the results from the sample.

The key requirements in sampling are that the auditor will determine a sample size sufficient to reduce sampling risk to an acceptably low level and will select the sample in a way such that each sampling unit has a chance of selection. Where any misstatements or deviations are found in a test sample, the auditor must evaluate their possible effect on the purpose of the audit procedure. This may result in the auditor having to perform additional or alternative audit procedures. In addition, misstatements identified in a sample must be projected across the sample population.

From our monitoring reviews of audit firms and their audit work, the common deficiencies that we find in relation to compliance with ISA 530 are:

- Not recording how sample sizes are calculated
- Where risk factors have been identified for key risk factors at planning, these have not been applied when calculating sample sizes. For example, where revenue recognition has been identified as a significant audit risk at planning, but the sample size has been reduced on the basis of completeness of income being a low risk.
- Not recording the auditor's justification for the sample sizes calculated, particularly where the audit programme methodology used includes a limit or cap on the sample sizes.
- Not using the sample size calculation methodology correctly, for example, reducing the sample size because of reliance on controls when controls testing is not undertaken.
- Not recording how samples have been selected.
- Splitting the sample size across more than one assertion in an audit area.
- Not extrapolating errors identified in samples tested.
- The above indicates that some firms are not applying the requirements of the standard correctly.

- From Appendix 4 of the ISA 530 standard, examples of sample selection methods include:
  - Random selection – using random number generators
  - Systematic selection – using the number of items in the population, divided by the sample size to give a sampling interval from a determined starting point, for example, every 50th item.
  - Monetary unit sampling – selecting samples based on monetary value.
  - Haphazard selection – auditor selects samples without using a structured technique. However, the auditor must avoid any conscious bias or predictability in selecting samples using this method to ensure that all items in the population have a chance of selection.

The standard provides guidance in Appendices 2 and 3 on how to apply factors that may increase or decrease calculated sample sizes.

ISA 530 is a relatively short, concise standard and it is recommended that where the auditor is not clear on any aspect of audit sampling, that they revert to the standard again as a starting point.

WALKTHROUGHS

A consistent finding during audit monitoring reviews is the lack of walkthroughs being completed at the planning stage, or at all.

The requirement for auditors to conduct walkthrough (observation and inspection) testing on an annual basis comes from ISA (UK) 315 (REVISED JULY 2020): Identifying and Assessing the Risks of Material Misstatement.

Walkthroughs, or observation and inspection, is part of the risk assessment process of the audit, and therefore no audit assurance can be taken from these procedures. Walkthroughs are not test of controls.

ISA 315 states that auditors must identify and assess the risk of material misstatements, whether due to fraud or error, at the financial statement and assertion level to provide a basis for the subsequent audit tests (Para.11).

The risk assessment process must include each of the following (Para.14):

- Enquiries with management and others involved in the system of internal control. The auditor should discuss and document the internal control system, this should be the processes and controls used by management to address the risks that they have identified.
- Analytical procedures. These should be used to identify unusual movements and balances when compared to the prior year or other expectation. and
- Observation and inspection. These are used to confirm, or contradict managements description of the processes and controls used. (Para.A32)

Where policies or procedures are not documented, or the entity has less formalised controls, the auditor may still be able to obtain some audit evidence to support the identification and assessment of the risks of material misstatement through observation or inspection of the performance of the control. (Para.A33)

For example, where procedures for the stock count are not documented, the auditor can gain an understanding through direct observation of the count.

The auditor may be able to observe segregation of duties or passwords being entered to demonstrate IT access controls.

The results of the risk assessment process should be used to identify and conclude on the risk assessment and be used to design and implement audit tests to address the risks identified.

ANALYTICAL PROCEDURES – ISA 520

Another finding is that substantive analytical procedures are being undertaken but these are not in accordance with ISA 520 and as such no audit assurance can be taken from these.

ISA 520 covers four steps that the auditor should undertake when designing and performing substantive analytical procedures:

- Develop an independent expectation (ISA 520 (5c)) – Develop an expectation of recorded amounts or ratios and evaluate whether the expectation is sufficiently precise to identify a misstatement that, individually or where aggregated with other misstatements, may cause the financial statements to be materially misstated.
- Define a significant difference for threshold (ISA 520 (5d)) – Determine the amount of any difference of recorded amounts from expected values that is acceptable without further investigation.
- Calculate the difference between the recorded amount and the independent expectation.
- Investigate significant differences and draw conclusions (ISA520 (7)) – The fourth and final step is the investigation of differences above the threshold defined in Step 2. These should be investigated by
  - Inquiry of management and obtaining appropriate audit evidence relevant to managements responses
  - Performing other audit procedures as necessary in the circumstances

Often practitioners compare the figures that are being audited to those of the prior year and comment on the movements. This may not meet the criteria above for the following reasons:

- Developing an independent expectation is a critical step in a robust substantive analytical procedure.

Changes to the business that have been noted at the planning stage are not always reflected in the expectation.

As an example, if a business has taken on or lost on a major customer this should be built into any independent expectation to ensure it is sufficiently precise.

On occasion it may be appropriate to compare the current period to the prior period but if that is the case, the reasons why should be clearly documented.

- The threshold for a significant difference is not defined. If this is not defined, an auditor is unable to identify which differences should be investigated, and which can be accepted.
- Where significant differences are identified, practitioners will investigate through inquiry of management but do not take the next step of obtaining appropriate audit evidence relevant to managements responses.

Where a substantive analytical procedure does not meet the requirements of ISA 520, audit assurance cannot be taken from this procedure and alternatives procedure will be required to gain audit assurance.

FURTHER SUPPORT FOR PRACTITIONERS

The ACCA Regulation team will be supplementing these articles with quarterly webinars where the core focus will be an overview of the most recent quarterly article, designed to share common issues arising from recent audit monitoring reviews. You can register for the webinars using the following link where you will also be able to access recordings of previous webinars:

Webinars: Audit compliance and practice essentials.