

ABOUT INTERNATIONAL ACCOUNTING, AUDITING & ETHICS

International Accounting, Auditing & Ethics (IAAE) is an online service with resources to support the practical implementation of international standards on accounting, auditing and ethics.

It provides access to practical, high-quality technical information which benefits individual professional accountants, their local professional organisations and supports the standing of the global profession.

Features of IAAE include factsheets, practical guidance, webinars, case studies and topical articles, plus a regular ebulletin with the latest technical developments. These practical tools, written and delivered by specialists in their field, provide practical, accurate and reliable support to help Professional Accountancy Organisations (PAOs) and their members implement international standards and share in best practice internationally.

IAAE is a partnership offering and helps PAOs to provide technical support to their members, thereby supporting the professional and commercial environment locally. Working in partnership encourages the development of local technical knowledge within PAOs, allowing them and their members to be better positioned in their local regulatory markets.

ABOUT ICAEW AND ITS FACULTIES

ICAEW operates under a Royal Charter, working in the public interest. Established in the UK in 1880, ICAEW has been at the forefront of the accountancy profession. Today, we have over 144,000 members working in all sectors of the economy and in all sizes of organisation, in over 160 countries.

We have invested significantly to develop a portfolio of world-class technical resources, qualifications and services based on the principles of technical rigour, quality and integrity. As part of this we have developed a centre of excellence with seven specialist Faculties that are highly regarded by the international professional community.

International Accounting, Auditing & Ethics is a specialised service drawing upon the expertise in technical member support of the ICAEW's Financial Reporting Faculty and the Audit and Assurance Faculty.

This publication forms part of the *International Auditing Perspectives* series. It is part of the online resources of International Accounting, Auditing & Ethics. If you would like to find out more about the issues raised in this publication, please contact Katharine Bagshaw (Manager, Auditing Standards) at kbagshaw@icaew.com.

To find out more about how International Accounting, Auditing & Ethics can support the implementation of international standards visit icaew.com/iaae or contact Deborah Chaplin (Director, Faculties) at deborah.chaplin@icaew.com.

Introduction



Risk assessment and internal controls: continuing challenges for auditors brings together three articles on risk assessment and internal controls, written with extensive input from ICAEW members in practice. The articles deal with practical implementation issues and discuss the continuing challenges highlighted in regulatory reports, and in discussions between auditors, standard-setters and regulators.

Risk assessment issues include the:

- quality of linkages between risk assessment and response;
- need to demonstrate and document how professional judgement was applied; and
- definition, determination and understanding of 'significant risk' under the International Standards on Auditing (ISAs).

We look at the challenges auditors face in balancing the judgemental and quantitative aspects of risk assessment, and how and why standard-setters will be changing the risk ISAs.

On the internal controls front, we examine how auditors taking a substantive approach apply the requirements to understand and document the design and implementation of controls. We also consider the challenges associated with testing controls in smaller audits generally, dealing with deviations from the application of control procedures, revising the control risk assessment and adjusting substantive procedures where necessary based on the results of controls testing.

WHO WILL BE INTERESTED IN THESE ARTICLES?

The objective of this publication is to clearly articulate some of more intractable issues for auditors, standard-setters and regulators in the areas of risk assessment and internal controls.

For auditors, a better understanding of common challenges may help with planning and performing future audits by understanding of how work is sometimes wasted, and of the issues that exercise regulators. Auditors may also find it helpful to understand where standard-setters are likely to be going with the risk ISAs.

For regulators, a clearer understanding of the issues faced by auditors, particularly smaller firms, will help in developing practical suggestions for standard-setters, and clearer recommendations in their reports.

For standard-setters, we hope that shedding more light on the implementation challenges for auditors will support research work and the development of plans to revise the risk ISAs.

We hope that this publication will raise awareness of risk ISA issues and deepen the level of understanding of them among auditors, regulators and standard-setters. It is intended to promote debate and to contribute to the discussions about the risk ISAs that will take place in the near future. Ultimately, we hope that it will result in plans to deliver practical solutions.

Overview

Risk assessment and internal controls: continuing challenges for auditors brings together three articles on risk assessment and internal control, written with extensive input from ICAEW auditors. The articles discuss some of the issues that auditors of smaller, less complex entities continue to find challenging in these fundamental areas of the audit.

International Standards on Auditing (ISAs) apply to audits of all sizes and they must accommodate the largest and most complex of audits as well as smaller, less complex ones. While ISAs are intended to be scalable and capable of proportionate application, many auditors struggle to apply them efficiently, particularly to smaller, less complex entities audits. There are several reasons for this. One is a lack of understanding of the standards themselves among some auditors. But extensive educational efforts by professional bodies and others for over a decade have not eliminated these problems, some of which seem intractable. Another reason may be the ISAs themselves, and there is a belief in some quarters that International Auditing and Assurance Standards Board's (IAASB) planned modernisation of the risk ISAs should include a review of the fundamental concepts underlying the ISAs, as well as their structure and detailed content.

These articles are intended to stimulate and inform debate. They are not a comprehensive review of issues with ISAs 315 *Identifying and assessing the risks of material misstatement through understanding the entity and its environment* and 330 *The auditor's procedures in response to assessed risks* (the risk ISAs). That major undertaking is for standard-setters and the IAASB now has these ISAs on its agenda. An initial discussion is scheduled for the March 2016 meeting.

The last substantive revision of the risk ISAs was finalised in 2003. While there is general agreement that the clarity project, finalised in 2010, made them somewhat clearer, if not a great deal shorter, no significant substantive changes were made at that time.

IAASB's post-implementation review of the clarified ISAs highlights a number of important areas in the risk ISAs that require investigation, including the need for modernisation. IAASB is drawing heavily on this detailed review as part of its plans to revise the risk ISAs. Regulators are aware that some of these issues pre-date not just clarification, but the last substantive revision in 2003.

The three articles all focus on the audit of smaller, less complex entities, because the requirements of ISAs have a disproportionate effect on such audits, but many of the issues highlighted are equally relevant to larger audits.

The three articles cover:

- aspects of risk assessment and the auditor's response thereto that continue to present challenges to auditors, and issues for standard-setters, including IAASB's plans to address them;
- continuing challenges to auditors arising from required audit work on documenting and testing internal controls; and
- required audit work on the design and implementation of internal control components: this article first appeared in the May 2014 edition of *Audit & Beyond*.