Generally, incorporating information technology, digitization, and artificial intelligence into audits and of using computer-assisted software is a welcome thing.

I have the following two general comments:

A. The concept of commercial software and the associated effects on audits have a conceptual flaw.

The term "commercial software" in A149 as well as in A181 apparently means software to whose source code the company has no access in spite of the option of customizing. This "commercial software" is only intended for small companies and simple processes according to the concept in ISA 315. Under A181, it leads to this software not being relevant to audits and the audit evidence then being obtained by substantive testing.

The advantages of consistently applying IT processes are pointed out in the current version of ISA 315.A76. This leads to the mere determination of the existence of automatic controls being sufficient to determine their effectiveness. Further audit procedures are then no longer necessary.

This approach is generally correct regardless of whether commercial software or customized software is used. However, new technologies allow a broadening of this approach.

Here is an example of this from online retail:

All necessary platforms and other services to operate an online shop can be rented by a company from providers. For example, if a company decides to use Amazon as a provider, the company is tied to Amazon’s online order processes. This ensures that only complete data sets such as address data and payment data can be processed. The platform provider specifies a very specific workflow from the order to the delivery, billing, and payment from which the company cannot deviate.

Consequently, commercial software requires a very specific workflow within a company that cannot be deviated from since the workflows are automated, and interventions to the workflows are only made in the event of disruptions. Moreover, only complete data sets can be processed. The applications normally test at least the completeness of data as well as specific relations such as whether the postal code, street, or the credit card information are present. They also normally check delivery capacity, inventory, etc.
This means that even for what is known as commercial software, over whose source code the company has no influence, relevant control processes can be derived, and these control processes are important for auditing. Consistent application of the process and the forced workflow are an advantage in terms of ISA 315.A76 and are an auditing starting point that assumes that there are effective controls.

In principle, this aspect can also be applied to customized software, but normally a precise analysis is required to see whether the system can be circumvented. That is virtually ruled out for commercial software without access to the source code. Changing the predefined workflows is hardly conceivable, for example, when using platforms if the company would have to intervene in the workflow process with Amazon as a platform provider.

There is also another aspect that has not been considered up to this point:

If a company decides to use the Amazon platform, not only is its workflow specified, but there are consequences regarding the quality of information that are important for accounting and auditing. A customer that places its first order from the company via the platform is initially a new customer for this company, but not for the platform. The customer is signed up with Amazon, has an order and payment history, and can be assessed regarding its payment practices. This also applies to the frequency of complaints and return shipments. The company would not have this information if it only had its own application, which would make new online business more expensive, such as from return shipments and default rates of accounts receivable.

The use of big data in company networks also affects the quality of the information.

I think this aspect should be included in A180 to A 187. The current approach contained in ISA 315.A76 should be maintained.

B. Concept of significant risks

Maintaining the concept is a welcome thing. The question arises as to whether the catalog should be expanded in order to more clearly point out special risk situations. In my view, the necessity comes from the fact that the scope of ISA 315 has increased considerably, and important risk aspects may possibly be lost in the full text because the connections are no longer easily recognized because the catalog is split up throughout the text. The section starting at A229 provides the opportunity to point out these items.

They are primarily two items:

If the financial statement framework allows fair value valuations, and the valuation is done by model calculations, some of which are conducted by external consultants and not by the company itself, there is a risk of incorrect balance sheet recognition, especially when the balance sheet items are significant. This risk only comes from applying the model calculation because the model calculation is used when information on valuation cannot be obtained due to stock exchange or market prices or prices obtained from stock exchanges or markets. These “level 3” valuations can hardly be judged objectively.
The IFRS draft on the conceptual framework dated March 2018 contains items that in my view should be included in ISA 315 if a significant risk as described above is determined based on fair value valuations.

In IFRS draft number 5.14 “Existence uncertainty,” it is pointed out that inflows with a low probability and high spread do not constitute relevant information for valuations, and thus the requirements for an asset are not met. This would result in capitalization being eliminated.

These items are further explained in 5.15 to 5.17 of the draft.

In the existing ISA 315 draft, the aspects are scattered. We find the notice about fair value information in A142. In A214, there is a notice about the sensitivity analysis that is supposed to verify the underlying assumptions for valuation procedures.

In A229, accounting estimates with high valuation uncertainty, complex models, and complex data collection are stated as significant risks, but that is not sufficient in my view. That is too unclear.

The risk situation from applying fair value valuations with the help of complex model calculations should be very clearly pointed out, and if the sensitivity analysis or other methods produce a high degree of uncertainty and large ranges, the test used for the issue of whether something is an asset or a liability under the financial framework concept that is used should be expressly indicated as an item in the audit procedures to be conducted.

This applies to the entire area of public sector entities, and we must assume that these valuation methods will increase as we bring in experts and service providers in the future.

The same applies to the item “revenue recognition.” Here as well, a significant risk should be specifically stated when complex model calculations are used to enter revenue.

These two items should be included in a focused way under significant risks starting with section A229.

In conclusion, I would like to show my express approval for the proposal to voluntarily apply the revised regulations of ISA 314 to audits before 12/16/2020.

Sincerely,

Dr. Richard Wittsiepe