SSA240 Fraud intentional act by one or more individuals among mgmt, TCWG, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage. Primary respb lies in mgmt & TCWG; auditor only to obtain reasonable assurance that FS on a whole are free from MM due to fraud; and can take docs given as genuine unless there are reasons to believe otherwise

Types of Fraud: (1) Fraudulent FR: (a) revenue recognition (b) acct estimates e.g. intentional MM on sales returns, provisions; (c) complex, unusual or related party transactions e.g. made outside normal course of biz, disposal of unwanted liabilities or recording fictitious sales to unconsolidated related parties (2) Misappropriation of Assets: (a) embezzlement e.g. Misappropriating collections of ARs; diverting receipts wrt written-off acc to personal bank acc; (b) theft of physical asset or IP e.g. stealing inv for personal use or for sale; stealing scrap for resale; colluding with a competitor by disclosing tech data in return for pmt; (c) inapp pmt for goods & svcs not received e.g. pmt to fictitious vendors, kickbacks paid by vendors to the entity's purchasing agents in return for inflating prices; (d) inapp use of entity's asset for personal use e.g. as collateral for a personal loan or a loan to a related party **Drivers of Fraud:** **(1) Incentives/Pressure:** e.g. mgmt is under pressure, from sources outside or inside the entity, to achieve expected (or unrealistic) financial outcome esp when consequences to mgmt for failure is significant; indivs may have an incentive to misapp assets as living beyond their means; (2) Opportunity: when an indiv believes IC can be overridden due to their position or knowledge of IC; **(3) Rationalization:** indivs that possess an attitude, character or set of ethical values that allow them intentionally to commit a dishonest act; or self-persuasion **Other Factors:** size (smaller easier as less seg of duties), complexity (more complex easier to hide fraud activities), and ownership characteristics (i.e. if sole prop no IA function etc. → e.g. large firm with TCWG providing effective oversight, effective IA function, written code of conduct prevents fraud) **Risk Response to Assessed RMM due to Fraud:** **Overall Level:** incorporate an element of unpredictability in the selection of the nature, timing and extent of audit procedures e.g. perform substantive procedures on selected account balances and assertions not otherwise tested due to their materiality or risk; adjust timing of audit procedures from otherwise expected; use diff sampling methods; perform audit procedures at diff locations or at an unannounced basis **Assertion Level:** (1) Test for mgmt override: Select journal entries that = complex transaction, end of reporting period, unusual transactions, internal control overridden (2) Test for acct estimates: Evaluate mgmt judgment for posb bias; perform retro review of significant mgmt judgments

Code of Professional Conduct & Ethics **(Conceptual Framework)** Requires PA to identify, evaluate and address threats to compliance with **Fundamental Principles:** **(1) Integrity:** PA to be straightforward and honest in prof and biz r/s. Implies fair dealing and truthfulness → don't deal with materially false or recklessly furnished statements, omission/obscuring info that will be misleading **(2) Objectivity:** PA to not compromise prof or biz judgment due to bias, conflict of i/r, or undue influence of others → INDPCE in mind & appearance **(3) Professional Competences and Due Care:** PA to maintain prof knowledge and skill at level required for client to receive competent svc + act diligently (respb to act in accordance with the req of an assignment, carefully, thoroughly and on a timely basis) with applicable stds when providing PA svcs → divided into 2 phases: (a) attainment (working in prof capacity with app training & supervision) (b) mtce of prof competence (continuing awareness and understanding of relevant tech professional and biz devlpmt) **(4) Confidentiality:** PA to refrain from disclosing private info to others, using private info for personal adv in social env and after end of r/s btw PA and client / employer UNLESS law requires it / permits it + consent from client / prof duty or right to disclose e.g. to comply with investigation, quality review by regulatory body, **(5) Professional Behavior:** to comply with relevant laws and regulations and avoid action that may bring disrepute to profession i.e. should be truthful and honest and not make exaggerated claims for svcs they are able to offer etc, OR make disparaging ref or unsub comparisons to the works of others

Threats to Fundamental Principles: **(1) Self-interest:** Financial or other i/r in client of PA or their immediate family member e.g. undue dpce on total fees from a client, having close biz r/s with client, concern about posb of losing client, potential e/m with client, contingent fees relating to audit svc, loan to/from client **(2) Self-review:** previous judgment needs to be re-evaluated by PA respb for that judgment e.g. reporting on operation of fin systems after being involved in their design and imp, performing svc for client that directly affects subject matter of audit svc, previous e/m r/s of assurance team member **(3) Advocacy:** when PA promotes a position/opinion to pt that subq objectivity is compromised e.g. promoting shares in listed entity which is the client, acting as an advocate on behalf of an assurance client in litigation or disputes with third parties **(4) Familiarity:** PA becomes sympathetic to i/r of client due to close r/s e.g. via family, past elm, or accepting gifts/pref treatment from client unless value is insig, long assc of snr personnel with client (auditor rotation) **(5) Intimidation:** Perceived or actual threat e.g. threatened with dismissal, litigation, pressured to reduce work inappropriately in order to reduce fees (window shopping)

Safeguards by prof/legislation/regulation: (a) Educational, training and experience requirements for entry into the profession; (b) Continuing prof dvlpmt requirements; (c) Corp gov regulations; (d) Prof standards; (e) Prof or regulatory monitoring and disciplinary procedures; (f) External review by a legally empowered 3rd party of the reports & other info provided by the PA **Safeguards in the work envt:** (1) firm-wide: leadership stress compliance, doc policies & procedures to implement and monitor quality ctrl of engagement, disciplinary mechanisms, use diff partner or teams for non-audit svcs (Chinese wall); (2) engagement-specific: rotating snr assurance team personnel, indpt 3rd party review, disclosure and breakdown of svcs fees **Provision of non-assurance svc (may create threats to indpce of audit firm due to self-review threat):** (1) book-keeping: PROHIBITED UNLESS it is to subsidiary (with conditions: (a) svcs do not involve exercise of judgment; (b) subsidiaries for which the svc is provided are collectively immaterial to the audit client; and (c) fees to the firm from such svcs are collectively clearly insignificant < $10k or 5% consolidated audit fees) or in emergency situation → all safeguards needed: (i) The firm should not assume any managerial role nor make any managerial decisions; (ii) audit client should accept respb for the results of the work; and (iii) personnel providing the svcs should not participate in the audit) (2) valuation: DPDS if material to FS in aggregate & if it involves sig degree of subjectivity → if not sig: safeguards = (a) involve an additional PA who was not a member of the assurance team to review the work done; (b) confirm with client their understanding of the valuation underlying assumption & method used and obtain approval for their use; (c) Obtain the audit client's acknwldgmt of respb for the results of the work performed; and (d) personnel providing such svcs do not participate in the audit engagement.(3) taxation: ALLOWED (4) IA: PROHIBITED for listed-entity (5) IT systems svcs: PROHIBITED for listed-entity which involves design and/or implement of fin info tech systems forming part of client's FS, (6) temp staff lending from audit firm to client: ALLOWED (particularly in emergencies) but with conditions i.e. personnel will not be involved in: (a) Making mgmt decisions; (b) Approving or signing agreements or other similar documents; or (c) Exercising discretionary authority to commit the client → safeguards: (i) staff providing assistance should not be given audit respb for any function that they performed or supervised during their temp staff assignment; and (ii) audit client should acknowledge its respb for directing and supervising the activities of firm (7) litigation support svcs: DPDS on (a) materiality of the amts involved; (b) degree of subjectivity inherent in the matter concerned; and (c) nature of the engagement → safeguards: (i) Policies to prohibit indivs assisting the audit client from making managerial decisions on behalf of the client; (ii) Using profs who are not members of the assurance team to perform the service; or (iii) involvement of others, such as independent experts. (8) recruiting snr mgmt for client (self-interest, familiarity and intimidation threats): DPDS on (a) role of the person to be recruited; (b) nature of the assistance sought e.g. OK: reviewing the professional qualifications of a number of applicants and provide advice on their suitability for the post; NOT OK if its recruiting C-level executives or other high level mgmt that can direct sig influence over FS (9) corporate finance and similar activities (advocacy and self-review threats): NOT OK (a) promoting, dealing in, or underwriting of an assurance client's shares; (b) committing the client to the terms of a transaction or consummating a transaction on behalf of the client; OK but with safeguards (a) help client develop corporate strategies (b) identify or intro a client to possible sources of capital that meet their criteria; (c) provide structuring advice (d) assist client in analyzing the acct effects of proposed transactions → (i) Policies to prohibit indivs assisting the audit client from making managerial decisions on behalf of the client; (ii) Using profs who are not members of the assurance team to perform the service; or (iii) Ensuring the firm does not commit the assurance client to the terms of any transaction or consummate a transaction on behalf of the client

Assertions Representations by mgmt that are embodied in the FS, as used by auditor to consider the diff types of potential misstatements that may occur → Some assertions are more impt than others! → Auditors generally assume entity will present (+) FS → identify those at the greatest risk of RMM → direct effort to these areas

P/L	Balance Sheet	Presentation & Disclosure
Occurrence: genuine & pertain to entity **Completeness:** all trans are recorded & only once **Accuracy:** appropriately recorded **Cut-off:** in correct acct period **Classification:** in proper a/cs	**Existence:** asset/ liab/ equity i/r exist **Completeness:** all bal recorded & only once **Rights & Obligations:** assets controlled & obligated for liabs **Valuation & Allocation:** all valued at appropriate amts, & any allocation adj app recorded	**Occurrence and Rights & Obligations:** disclosed items occurred & pertain to entity **Completeness:** all disclosure required is made **Classification & Understandability:** appropriately presented & clearly expressed **Accuracy & Valuation:** fairly disclosed and at appropriate amts

Tend to Overstate		Tend to Understate	
Revenue: Occurrence, Accuracy, Cut-off	**Assets**: Existence, R&O, Valuation & Allocation	**Expenses:** Completeness, Accuracy, Cut-off	**Liabilities**: Completeness, Valuation & Allocation

Note: Linkage b/w accounts and assertions – if there is RMM in a class of transactions, likely to have RMM in account balance; RMM in sales due to inaccurate cut-off → RMM in A/R (completeness and existence); Linkage b/w assertions and testing – evidence from test of controls (generally directed at transactions) that purchases are complete → trade creditors are complete → extent of substantive testing (generally directed at acc balances) on completeness of trade creditors can be reduced

Audit Risk Model = RMM (IR x CR) x DR = AR

(1) Audit risk: that auditor expresses inappropriate opinion (always set low) **(2)** Understand the entity and its envt, including IC (SSA315) **(3a)** **Inherent risk:** susceptibility to MMs BEFORE related controls (Entity & Envt) **(3b) Control risk:** that MM is not prevented, detected, or corrected by IC (ICs) **(4) Risk of material misstatement:** Determined from 2 **(5)** Determine level of **Detection risk**: that audit procedures will not detect MMs to achieve 1 → Higher RMM = lower DR set → higher quality & qty of audit evidence required; = lower **materiality** (misstatement or aggregate of >1 MM is significant to influence the economic decisions of users of the FR)→ auditor will increase testing (qty of audit evidence)

SSA315: Performing Risk Assessment To identify and assess the RMM, whether due to fraud or error, at the FS and assertion levels, via understanding the entity and its environment, including the entity's IC; basis for designing & implementing responses to assessed RMM

1. Gathering information about the entity → A. The Entity & its Environment → Assess IR

(i) Industry, Regulatory & Other External Factors, incl. FR framework: Industry: incl. competitive environment, supplier & customer r/s, tech developments. Consider: highly price-competitive = pressure on results (FS level) or inventory valuation due to NRV (a/c level); cyclical or seasonal demand = CF difficulties due to mismatch btw inflow & outflow; nature of industry = judgment required to estimate future contract rev and cost; prdt tech related to entity's prdt; Regulatory: FR framework, legal, political environment. Consider: acct principles, industry-specific practices; regulatory frameworks e.g. MSA regulators increase obligations and hence compliance cost, taxation, legislation/regulation that significantly affect entity's operations, relevant govt policies e.g. monetary, FX ctrls, fiscal, financial incentives (govt aid), tariffs i.e. increase cost of doing biz, trade restriction policies; envt requirements; Ext factors: general econ envt, i/r, availability of financing, inflation, currency revaluation

(ii) Nature of Entity: Operations: how an entity earns and recognize revenue (e.g. LT sales contract give rise to cut-off issues and potential going-concern if lost, huge upfront cost with low-margins leads to concern over sales condition + inv valuation), product and svcs provided, markets (e.g. internet sales?); conduct of operations e.g. activities exposed to envt risks; alliance, JVs, outsourcing; geographic locations incl. production facilities and offices etc.; key customers & impt suppliers, e/m arrangements e.g. union contracts, pension; R&D; related-party transactions; Type of investments: in income producing assets e.g. securities, loans; new biz operations; capital investments; JVs, associates, special-purpose entities → auditor to consider appropriate acct treatment (fair value, depreciated cost) for each → e.g. AFS = gain/loss to equity, trading securities = gain/loss to P/L, held-to-maturity = cost; Structure & finance: debt structure and related terms incl. off-BS financing & leasing arrangements (e.g. higher level of debt, greater biz risk and RMM potentially going concern assumption might not be valid if sales decline); bank covenants motivate fraud; use of financial derivatives; beneficial owners & related parties (e.g. high debt to S/H = hard to classify btw equity & debt); major subsidiaries; Ownership & governance: e.g. active and appropriate structure of audit committee reduces risk due to enhanced oversight over FR reporting (CR) → Complex structure e.g. goodwill, JVs, special purpose entities → RMM,

(iii) Selection & Application of Acct Policies: Assess whether acct policies used are appropriate and design audit procedures that address acct policies. Consider: methods used for unusual transactions; significant acct policies in controversial areas with lack of guidance/consensus; new FR stds and laws/reg (when to adopt).

(iv) Objectives & Strategies & Related Biz Risks: objectives: overall plan for coy; strategies: game plan to achieve objectives; → related biz risks (to FR): expanding to new markets / locations, does ctrl still apply to new location / biz, and even if successful may not have adequate DD; if new prdt or svc, risk that new biz will fail and overvaluation of inv (?); flaws in prdt leading to rep risk & liabilities; industry developments w/o appropriate personnel to deal with changes; new acct / reg req leading to improper implementation / increase legal exposure; current/prospective financing req dpds on entity's ability to meet req which might lead to loss of it; use of IT leading to incompatible systems; changes in strategy

(v) Measurement and review of financial performance: Directed at whether biz perf is meeting objectives set by mgmt. Consider: Performance measures (KPIs) can create pressure on entity & motivate MM; compensation policies e.g. revenue as key measure of performance for mgrs increase incentive to overstate rev; period-on-period fin analysis; budgets, forecasts, variance analyses in segment, divisional or departmental e.g. variances in actual AR ratios FYE identified in mgmt analysis from forecast/prior ratios may indicate risk that AR is overstated; investment analysts focus on consistency of gross margin may indicate smoothing of earnings; comparison with competitors' performance

B. Internal Controls (Design & Implementation)→ Assess CR

Process designed, implemented, and maintained by TCWG, mgmt., and other personnel to provide reasonable assurance abt the achievement of an entity's objectives. → Only those relevant to the audit i.e. reliability of FR / address IR to MM identified above

1. Control envt (7 elements): foundation on which other ICs are built = PERVASIVE (a) Communication & Enforcement of Integrity & Ethical Values: what mgmt actions serve to eliminate or mitigate incentives prompting personnel to engage in fraud? E.g. mgmt continually demonstrate commitment to high ethical stds, code of conduct, employees know acceptable/unacceptable behavior, enforcement actions taken
(b) Commitment to Competence: personnel have knowledge and skills necessary to accomplish their tasks? E.g. job descriptions effectively used, training, ongoing matching of staff skills to their JDs (c) Participation by TCWG: how effective is gov over entity's ops? E.g. majority of TCWG are indpt & have appropriate competencies, sig issues are timely reported to TWCG, meet on regular basis, provide effective oversight by asking diff qns (d) Mgmt's Philosophy & Operating Style: mgmt's attitude and actions towards FR i.e. over sound IC over FR, app selection of acct policies, info processing ctrls, treatment of acct personnel E.g. established procedures to prevent unauthorized access to stuff, analyses biz risks and takes app action (e) Organizational Structure: app to facilitate achievement of objectives, op functions, and reg requirements e.g. segregation of incompatible duties, structure facilitates flow of reliable/timely info to app people for planning and control activities, mgmt respb (f) Assignment of Authority & Respb: e.g. policies for authorization & approval of trans, app lines of reporting dpding on entity's size and nature of activities, risk owners assigned in JDs (g) HR Policies & Practices: what stds are in place to ensure recruitment of the most competent/trustworthy people & training is provided to ensure ppl can perform their jobs? Promotions driven by performance appraisals? E.g. mgmt establish/enforce stds for hiring qualified ppl, extensive recruiting practices such as bg checks, periodic review of job perf with app action taken, training policies address prospective roles and respb, expected lvls of perf, and evolving needs **Audit Evidence:** Inquiries of mgmt → Corroborate inquiries via observation or inspection of documents e.g. whether mgmt has written a code of conduct and act in a manner supporting the code / how mgmt responded to findings and recoms of IA regarding deficiencies in IC relevant to audit

2. Risk Assessment = PERVASIVE Consider how mgmt. identifies FR risks, estimate sig and likelihood of risks, and decides on actions to manage them. If process is appropriate → can assist auditor in identifying RMM ⇔ **Compare with identifying IR by auditor:** If auditor identified RMM that mgmt failed to, consider why mgmt process failed and their appropriateness to the circumstance. **Factors that might affect CR:** (a) Changes in operating environment (regulatory or operating changes can lead to competitive pressures and other different risks) (b) New personnel (different focus or understanding of controls) (c) New / revamped information systems (d) Rapid growth (increased risk of a breakdown in controls due to strain) (e) New technology (change risk associated with IC) (f) New business models, products or activities (g) Corporate restructurings (accompanied by staff reduction, changes in supervision and segregation of duties) (h) Expanded foreign operations (e.g. foreign currency risks) (i) New accounting pronouncements (e.g. new accounting standard) **Audit Evidence:** Inquiries of mgmt

3. Information System Includes procedures to: (a) Initiate, record, process, and report entity transactions & to maintain accountability for the related assets, liabilities, and equity; (b) Resolve incorrect processing of transactions, for example, processing error files to clear suspense items out on a timely basis; (c) Process and account for system overrides or bypasses to controls; (d) Transfer info from trans processing systems to the general ledger; (e) Capture info relevant to FR for events other than trans e.g. depreciation/amort of assets, changes in recoverability of AR (f) Ensure info required to be disclosed by the applicable FR framework is accumulated, recorded, processed, summarized and appropriately reported in the FS. → Auditor required understanding (1) how sources of info are used (2) how info is captured and processed (3) how info produced is used **Audit Evidence:** Inquiries of mgmt and TCWG, inspect available system documentation

4. Control Activities **Preventive Controls:** to prevent errors or omissions from occurring & are positioned @ source of the risk within a biz process e.g. (1) Authorizations: written policies, limits to authority, supporting docs, qns unusual items, no "rubber stamps"
Detective/Corrective Controls: to detect + correct an error/fraud/omission within biz process (1) A/cs Reconciliations: comparison of diff set of data, identifies + investigate differences, taking corrective actions when needed e.g. general ledger vs. filed invoice copies; (2) Performance Reviews i.e. Variance Analysis: budget vs actual, current vs prior period comparisons, perf indicators (KPIs), follow up on unexpected/unusual items **Both:** (1) Physical & Access Control: for physical and intellectual assets, perpetual records maintained, periodic stock counts, compare counts to perpetual records, investigate differences (2) Seg of Duties: No one person should initiate, approve, record, reconcile transactions, handle assets, review reports = at least 2 set of eyes; (3) Controls over IS: General controls – operate across all apps and usu consist of a mixture of automated and manual ctrls (IT budgets, contracts with svc providers) e.g. (1) stds, planning, and policies, (2) security over data, IT infrastructure and daily ops, (3) access to program and application, (4) program dvlpment and changes, (5) monitoring of IT operation; Application Controls – automated ctrls relate specifically to apps (payroll, sale processing) (input ctrl: authorization, validation, error notify, processing ctrl: record count [complete & accurate of validated trans], output ctrl: error listing [audit trail for review])
In general to gain understanding of ICs: inquiries of personnel, observe/re-perform application of specific ctrls, inspect docs & reports, walkthrough tests (trace one or two transactions through the IS)

5. Monitoring = PERVASIVE Assess effectiveness of IC performance over time: Internal – IA evaluation, compliance with entity's policies; External – review customer complaints, comments from auditors, regulators, biz partners. → Auditor to understand the sources of the information related to monitoring activities; and the basis upon which mgmt considers the info to be sufficiently reliable for the purpose,

2. Risk Assessment Procedures

1. Enquiries of mgmt & others: e.g. (a) discuss acct function with financial controller to det if staffs have req skills to prepare FS, (b) discuss mkt conditions with sales mgrs to det if there are any material ext risks 2. Observation & inspection: observe how entity operates and is org, premises and facilities, mgmt. operating style towards ICs, operation of IC procedures, compliance with key policies; inspect documents related to biz plans, strategies and proposals, industry studies and media reports, major contracts, correspondence with regulators 3. Analytical procedures (preliminary): typically performed at high level to provide broad indication of if any MM exist → **TREND** or **RATIO**: (1) ST Liquidity: (a) Current Ratio = Current A / Current L; (b) Quick Ratio = [Cash + Cash Eq + Net Receivables] / Current L; (2) Receivable Ratios: (a) AR Turnover = Net Sales / AR (b) Days sales in AR = 365 / Turnover; (3) Inventory Ratios: (a) Inventory Turnover = Cost of Sales / Ending Inv; (b) Days sales in Inv; (4) Profitability Measures: (a) Net Profit Margin = NI / Sales; (b) Gross Margin = Revenue / Sales; (c) ROE = Net Income / SH Equity; (5) Financial Leverage Ratios: Debt-to-Equity: Total L / SH Equity; (6) Capital Turnover Ratios: (a) Asset liquidity: Current A / Total A; (b) Sales to assets: Net Sales / Total A; **NB:** Look at nature of company to determine key balances e.g. trade receivables, inventory, and payables for retail coy → calculate ratios → see if potential MM due to over/understatement e.g. signs of inventory obsolesce → check for unusual r/s e.g. slowing collection of AR but no change in bad debt etc. → key assertions at risk

3. Use Information to Assess the RMM

(1) Assess if identified risks is → Risk at FS level = **PERVASIVE** or Risk at assertion level = **SPECIFIC**
(2) Det whether any of the risks identified is a significant risk (RMM is highest, assessed before considering controls i.e. IR = L x C)
6 factors to consider: (1) risk of fraud? (2) related to recent sig economic, acct, or other developments? (3) complexity of trans (4) related-parties trans (5) degree of subjectivity in measurement of fin info (6) sig trans outside entity's normal course of biz
(3) Understand controls related to significant risks: (a) review of assumptions by senior management or experts; (b) Documented processes for estimations (c) Approval by TCWG. e.g. receipt of notice of a significant lawsuit →referred to appropriate experts (legal counsel), whether an assessment has been made of the potential effect, and how it is proposed that the circumstances are to be disclosed in the financial statements

SSA320: Determining Materiality Levels

FS level: **Overall Materiality** (1) Determine what info is of most interest to users e.g. profit before tax for for-profit orgs, NGOs focus on maximizing expenses (2) identify what major elements of the FS will be of i/r to users e.g. assets, liabilities (3) consider nature of entity (lifecycle, industry, and econ envt) e.g. mature coy very stable profits, start-ups no profits so may use total assets (4) if entity is financed mainly via debt rather than equity (more emphasis on pledged assets, CF, and any claims) (5) volatility of proposed benchmark (needs to be stable) e.g. if breakeven, use revenue rather than NPAT → (6) alternatives for special circumstances e.g. current assets, net working capital, CFO, total equity etc. Examples (**note**: higher RMM → lower % materiality!):
Publicly listed entities: Profit before tax from continuing activities (3-7%) **Trading entities:** Total revenue (0.5-2%) or Profit before tax (3-7%)
Not-for-profit entities: Income (0.5-2%) or Total expenses (0.5-2%) **Commission-based entities:** Profit before tax (3-7%)
Asset/Investment-based entities: Total assets (0.5-2%) **Owner-mged entities:** Profit before owner remuneration and tax (3-7%)
Performance Materiality: RMM High = 50-60%, Medium = 65-75%, Low = 80-90%
Assertion level: **Specific Materiality** (< OM but can affect economic decisions of users of FS, for particular a/cs) (1) laws, regulations & acct framework req e.g. sensitive FS disclosures, related party transactions, stat reporting req, certain types of exp such as illegal pmts (2) key industry disclosures e.g. R&D for pharmaceutical (3) disclosures of sig events and impt changes in operations e.g. newly acquired biz, discontinuity operations, unusual events or contingencies, intro of new prdts

SSA330: Auditor's Response to Assessed Risks → Overall Responses (FS Level) & Assertion Level

Nature: **purpose** (TOC or sub procedure) and its **type** (inspection, observe, inquiry, confirmation, recalculation, reperformance, or ARP) e.g. if RMM is high → usu use external confirmations; if RMM is low due to controls, then use TOC, if not then sub procedures
Timing: when it is performed, or the period to which the audit evidence applies e.g. if RMM is high → sub procedures to be performed at YE.
Other factors: ctrl envt, when relevant info is avail, nature of risk e.g. inflating revenues, period to which audit evidence applies
Extent: qty to be performed, e.g. a sample size or the # of observations of a control activity, how detailed sub procedures are

Test of Controls: to evaluate operating effectiveness of ctrls in preventing, detecting, or correcting MMs (does ctrl works?)
(1) When determined at RA stage that ctrl design and implementation is ok → expectation that IC operates effectively OR (2) sub testing alone does not give sufficient evidence e.g. when each transaction is small but there are many, coy uses IT and no documentation avail
Extent: dpds on degree of reliance on ctrl, frequency ctrl is used, length of time in audit period auditor is relying on ctrl, expected rate of deviation from ctrl, relevance & reliability of audit evidence to be obtained, NO TOC FOR LOW RELIANCE ON CTRL

Frequency	High Reliance	Partial Reliance	
Annual	1	1	**For manual ctrls,** implementation of ctrl at a pt in time does not provide evidence of its operation at other times **For IT ctrls,** = expected to function consistently unless program changes → auditor confirms no changes are made i.e. app program change ctrls are working, authorized version of program was used for processing transaction, other relevant general ctrls are effective
Quarterly	2	1	
Monthly	2	2	
Weekly	5	4	
Daily	20	10	
>1 time a day	25	15	

Timing: for a particular time or throughout the period → if interim TOC was done, auditor will (1) obtain evidence of sig changes to ctrl since testing (talk to mgmt first to check for changes → verify that same version of application is still used → check activity log for access to modify program code) and (2) det additional audit evidence to obtain, considering: significance of RMM, specific ctrls tested and if sig changes made to them since testing, degree to which audit evidence on ctrl was obtained, length of remaining period, extent of reliance on ctrl to reduce sub procedures, ctrl envt → extend TOC to remaining period or test monitoring of ctrls
Test of IT controls: (a) Processing approaches i) Test data: feed valid + invalid test data usually ard threshold into client system (only at pt of time) ii) Integrated test facility: create dummy entity and enter simulated data along with real client data → permits continuous entry thru out acct period iii) Controlled processing: auditor is present when client undertakes CAs associated with inputting and processing transactions → compare results with their own with the same batch of client data iv) Parallel processing: comparison of transactions run through 2 programs (1 is auditor's, 1 client's) → compare results (b) Non-processing approach i) Program code review: review client's program documentation (source code) ii) Review of job acct data: reviews printed log produced as jobs are run for any excessive processing time, error conditions, or abnormal halts
Evaluating results from TOC: Auditor to understand why deviation occurred and decide if (a) evidence obtained supports reliance on ctrls; (b) additional TOC required; (c) sub approach is req to address RMM (i.e. risk assessment still appropriate?) Deficiency design (control necessary to meet control objective is mission) e.g. absence of segregation of duties; absence of appropriate approvals; inadequate controls over access to system, data and files; or deficiency operation (properly deigned but do not operate properly) e.g. indpt test of controls not working properly such that purchases outside of approved list is allowed; credit authorization overridden by sales manager, accounting records have been altered
IC deficiencies if significant → must be communicated on a timely basis to TCWG & mgmt at appropriate level (but not to provide opinion on ctrl effectiveness) → orally in first instance for them to take timely remedial action to min RMM → if not, sends mgmt letter
*NB: for any interaction btw ctrl activities i.e. failure of 1st ctrl leads to failure of subsequent ctrls

Substantiative Procedures: for detecting MMs at assertion lvl (after occurrence), directed towards actual dollar amts in FS
ALWAYS NEEDED for each material class of transaction, a/c bal, and disclosure & specially designed wrt to a Significant Risk
(1) Would Sub Proc be able to provide sufficient audit evidence alone? If no, Sub Proc only. If yes → (2) Is it more efficient to obtain evidence via TOC? (i.e. will reduce extent of sub proc required) → Mix of TOC & Sub Proc → (3) See if Sub ARP is viable / Sig risk?
Test of Details: used when direct evidence of the items that comprise of indiv amts in the FS is required → if only sub procedures are used for significant risk, MUST INCLUDE TODs
Sub Analytical Procedures: provide evidence by analyzing r/s btw financial data and fin/non-fin data to support TODs on same assertions → used when controls are strong (in combo with TOCs), there are large volumes of transactions, & when outcome of a procedure is predictable
Timing: if interim Sub Proc was done, auditor will cover remaining period by: (a) sub proc + TOC; or if det that it is sufficient, (b) further sub proc only (sub ARP btw interim and period end only if period end bal are reasonably predictable, entity has app procedures for analyzing and adjusting the bal at interim, and proper acct cut-offs, IS provides info on end bal that is sufficient to permit investigation of sig unusual transactions, other causes of sig fluctuations, & changes in composition of bal)
Target testing: select items to be tested based on some characteristics e.g. high $ or risk → target test all indiv transactions with bal above PM level → if untested bal remains material, apply **Non-Statistical Sampling** use certain sample selection methods to draw sample from untested bal e.g. random sampling → carry out sub testing for selected sample (use TE) → project misstatement of untested balance → add it to misstatement of tested bal to see if total estimated MM is > TE

SSA500: Audit Evidence need SUFFICIENT (qty [can be from > 1 procedures]) and APPROPRIATE (quality = relevance + reliability [influenced by source, nature and other circumstances increases when (a) external, (b) related ctrls of entity are effective, (c) obtained directly by auditor > inquiry, (d) document > oral (e) original docs]) AE to reduce audit risk to an acceptably low level (if AE is higher quality → less qty req)
Reliance on Other's Work, Ext Confirmations and Written Reps: (1) Internal Auditor: Is the work of IA adequate to external audit purpose? Factors: objectivity (free from bias, undue influence, conflict of i/r, indpce from mgmt), tech competences, use of systematic and disciplined approach (documented proc in place) → Works that can be used: testing op eff of ICs, sub proc with limited judgment, observe inv counts, walkthrough (trace trans relevant to FR through IS), test compliance with stat req → discuss planned use of work with IA → read reports by IA to confirm understanding of work performed, review findings → evaluate if work of IA was properly planned, performed, supervised, reviewed and documented, and sufficient evidence was obtained and conclusions app drawn, → reperform some testing work **(2) Experts:** auditor remains sole responsibility for opinion expressed. Scenarios: (a) valuation, (b) existence & condition of special assets, (c) coy has complex info system Factors: chosen expert must be competent, capable, and objective → auditor must understand expert's field of expertise (i.e. the process for expert's assessment, and decide if conclusion drawn is reasonable) **(3) External Confirmations:** Det info to be confirmed → select app confirming party → design confirmation request (to be sent back to auditor → send requests + follow-up requests to confirming party (a) determine if responses are reliable → if not, obtain further audit evidence to confirm doubts, consider fraud and other issues that impact RA, (b) no response → perform alternative audit procedures to obtain reliable audit evidence **(c) Exceptions identified** → Investigate exceptions to determine if they indicate misstatements on FS (d) evaluate overall results → whether they provide relevant and reliable audit evidence or further evidence required
(4) Written Representations: (a) if mgmt. provides, must consider if person making rep. is objective and knowledgeable on subject matter; must consider if rep. is reasonable in light of auditor's understanding of entity; whether further audit procedures are required to corroborate the reps; if auditor determines that mgmt. is incompetent or lack integrity, determine effect on reliability of reps; disclaim an opinion (b) if rep are inconsistent, perform additional procedures to resolve matter, if matter remains unresolved, need to reconsider assessment of ethical values/diligence of mgmt. and determine effect on reliability of rep; determine if there is a reason to doubt mgmt's integrity, discuss with TCWG and consider impact on risk

assessment; det if continued reliance on other management rep. is appropriate. (c) If requested reps not provided, discuss with management, reevaluate integrity of mgmt and evaluate effect it has on reliability of rep. take appropriate actions and disclaim an opinion on FS

Revenue Cycle

For Revenue, Occurrence; AR, Existence & Valuation (sales return / discount, bad debt, allow for doubtful, prov for warranty)

Receive customer order (Customer PO) → Det if goods are avail for shipment → Approving credit for sale → Shipping goods (Packing slip, bill of lading) → Bill customers (Customer Invoice) → Sends Mthly Customer Statement → Collect cash (Customer Remittance Advice)

1. Initial Risk Assessment: needs to obtain understanding on various accounts to identify →INHERENT RISK

Revenue: Timing of revenue recognition (occurrence, accuracy, cut-off): (1) Know revenue recognition criteria → FRS 18 = significant risks and rewards of the ownership of the goods have been transferred to the buyer; seller no continued managerial involvement; amt of revenue and cost wrt transaction can be measured reliably, (2) Entity's principal business (3) Earning process and the nature of the obligations that extend beyond the normal shipment of goods i.e. is there provision that needs to be raised? (4) Right of the customer to return a product as well as the history of the customer in returning merchandise (5) Revenue recognition policies NB: pt in time when rev should be recognized, unusual terms, hidden letters with unlimited rights to return, consignment, bundled products, all goods recorded as sales have been shipped and are not returned defect/ replacement/ unfinished goods; sales with abnormal returns **Accounts Receivables: Net amount is not collectible i.e. receivables do not rep genuine claims (existence, R&O); and insufficient allowance for uncollectible a/c (valuation):** (1) Credit policy (2) How does management estimate bad debt expenses (3) How does management write off A/R (4) Are receivables pledged as collateral against loans? (5) Whether collection of AR have contingent conditions **Fraud:** (1) Unusual financial results e.g. revenue increases in face of strong competition, not consistent with industry trend; large increase in sales made near the end of the quarter (2) Internal indicators e.g. mgmt compensation scheme; expiration of stock option e.g. if stock options are expiring, managers may attempt to boost stock price before option expires; complex transaction; acct personnel are not qualified; aggressive history (3) External indicators e.g. industry trend, analyst expectations

2. Initial Risk Assessment: need to understand the controls implemented by mgmt to tackle inherent risks → CONTROL RISK

Process to gain understanding = (1) walkthrough of process, (b) inquiry, (c) observation, (d) review client's documentation → consider both entity-wide (e.g. control envt) and specific ctrls **Existence / Occurrence:** (1) sales recorded only with valid cust order & shipping doc, (2) coy send mthly statements to custs (must be prepared & mailed by someone indpt of initial processing of transaction); (3) cust enquiries handled indptly from original recording of transaction; (4) mgmts authorize and review unusual transactions **Completeness:** (1) use pre-numbered shipping documents & sales invoices and subseq acct for all numbers; (2) reconcile shipping with billing records (FOB destination goods might still be in transit); (3) reconcile inventory with sales (e.g. sales return should not be part of inv) **Valuation/Accuracy:** (1) sales made from authorized computer price lists; (2) controls over correct inputs of authorized price change; (a) mgmt reviews list of changed prices and authorizes the changes; (b) reconcile input with printed output reports to ensure that all changes were made; (5) access controls to the price list – only authorized indivs can access and modify **Cutoff:** (1) transactions recorded upon entry of customer order and shipping info; (2) mthly statements are sent to custs → group indpt of recording the transactions follow up complaints **Classification:** (1) chart of accounts is up to date and used; (2) computerization of standard transactions to ensure consistency of classification (3) review of complex or unusual transactions **Sales Return:** (1) contractual return and warranty provisions are clearly spelled out in the sales contracts (2) Formal procedures to approve acceptance of returns and granting credits, determine potential obsolescence or defects in goods, ensure proper classify goods i.e. new goods are not re-shipped; (3) record goods returned on pre-numbered docs to ensure they are all recorded promptly **Allowance:** also related to valuation of A/R – formal credit policy, periodic review of it, cont monitoring of receivables for evidence of increased risk, adequate seg of duties in credit dpt with specific authorization to write off rec ⇔ indivs who handle cash transactions

3. Initial Risk Assessment: Perform Pre-ARP to identify a/c with potential RMM **Ratio analysis:** (1) Gross margin analysis, including a comparison with industry averages and prior years; (2) turnover in receivables; (3) aging of receivables; (4) allowance for bad debts as % of AR; (5) bad debt exp as % of net credit sales (unusually low ratio vs. prior year indicate allow has been understated) (6) sales in last mth to total sales (mgmt might have brought forward next year sale); (7) return & allow as % of sales (high sales return ratio indicate boosting of rev) **Trend analysis:** (1) compare client revenue trend with economic conditions and industry trends (revenue growth in industry downturn); (2) compare CF from ops with NI (NI increase while CFO is negative = A/R or inventory might be inflated); (3) mthly sales analysis compared with past years and budgets; (4) identify spikes in sales @ end of quarters/years (5) Reasonableness test after review contract and form expectation *SAP also!

4. For the identified RMM, determine audit procedures to perform: Higher risk = usually limited TOC and sub-AP → mostly TOD

5. TOC performed only if can rely on controls i.e. low CR: Select & test ctrls impt to identified RMM **Recorded transactions are authorized and actually occurred (Occurrence):** (1) Sales recorded only with valid customer order and shipping doc. = Sample recorded sales transactions and vouch back to shipping doc and customer order. (2) Credit is approved before shipment = Select a sample of customer invoice and vouch it back to customer credit report/mgt approval doc, compare customer balance with approved credit limit **Sales are recorded in the correct accounting period (Cutoff):** (1) Computer records sale upon entry of customer order and shipment. Transactions entered but not yet processed are identified for an exception report and followed up = Create dummy transactions in the system and check recording and billing of the transactions, review monitoring ctrls i.e. mgmt's review of trans entered into system but not shipped and billed (2) Transactions entered but not yet processed, are identified for an exception report and followed up. = Review monitoring controls (for e.g. mgmt's review of transactions entered into the system and not shipped and billed) (3) Monthly statements are sent to customers. A group independent of those recording the transactions receives and follows up complaints. = Review nature of complaints received. Investigate to determine if there is a pattern. **All sales are recorded (Completeness):** (1) Pre-numbered shipping documents and invoices which are periodically accounted for. = Review reconciliations to determine that control is working (2) Monitoring: transactions are reviewed and compared with budgets and differences are investigated = Review management reports and evidence of actions taken. **Sales are accurately recorded (Accuracy):** Sales price comes from authorized sales price list maintained on the computer = take a sample of recorded sales invoices and trace price back to authorized list. **Sales are correctly recorded (Classification):** Chart of accounts is up to date and used = take a sample of transactions and trace to general ledger to see if properly classified

6. Substantiative Procedures Sales-Occurrence/Accuracy A/R- Existence/Valuation and allocation: (1) Select transactions from ledgers and vouch them back to sales invoices (int), customer orders, bills of lading, bank statement, remittance advice (ext). (2) Confirm balances or unpaid invoices with customers. (3) Examine subsequent collections as evidence that sale existed. **Sales & A/R-Completeness:** (1) Trace bills of lading to sales invoice and sales journal. (2) Account for sequence of sales invoices in sales journal. **A/R-Rights and Obligation (e.g. A/R can be sold, discounted or pledged as collateral):** (1) Inquire of management about such arrangement (2) Review sales agreements and minutes of board meetings. (3) Scanning the cash receipts journal for relatively large inflows of cash that are posted from unusual sources. (4) Obtain bank confirmation on loan collateral **Sales &A/R-Valuation & Accuracy:** (1) Trace sales invoices to sales journal and customer's ledger. (2) Confirm balances or unpaid invoices with customers. (3) Reconcile customer ledger account with A/R ctrl acc (4) Review adequacy of allowance for doubtful debts. **Allowance for doubtful debts-Valuation:** (1) Inquire of management of collectability of customer balances and allowance estimation methods; write off procedures (2) Review A/R aging analysis. **Sales & sales return-Cut-off:** (1) For sales, select sample of recorded sales transactions from cutoff period to determine when trans occurred, and examine shipping terms and shipment dates to see if there was appropriate cutoff, (2) For sales return, select a sample of receiving report (date, description, condition, quantity of merchandise and approval of return) issued during the cutoff period and matched them to credit memo issued to customers

SSA505: Confirmations

Positive (need confirming party to reply agree/disagree) vs Negative (respond only if disagree): (1) RMM high = negative; (2) low prob of disregarding request, large # of small homogenous balances, expected low exception rate = negative; If doesn't reply: use alt audit procedures (5 docs e.g. subsequent bank statement). Errors: det if client MM, timing diff (shipment, pmt), cust error

Cash

→ Existence/Occurrence & Completeness

Lockboxes: PO box # = depository of coy's bank where cust are instructed to send their pmts to. The bank receives and opens remittances → prepare list of cash receipts of coy → credit the coy's cash a/c + notify coy via document listing customer receipts → Controls? (1) Send evidence of pmt to client to facilitate follow-up if customer has queries (2) reconcile total # of customer pmts to bank cash deposit records

Initial Risk Assessment: HIGH Inherent Risk: Large volume (more prone to errors); impt for meeting debt covenants (usu tied to cash balances or maintain min level of working capital, hence mgmt incentive to present favorable FS); highly liquid hence susceptible to fraud (e.g. lapping – steal pmt and use another customer pmt to cover, skimming – does not record sale and steal the cash either by writing off AR as uncollectible or recording a fictitious discount)

Initial Risk Assessment: Control Risk (1) Segregation of duties: (a) book keeping and cash handling are segregated (b) bank reconciliation and book keeping/cash handling are segregated (c) customer enquiries are handled separately (2) Indpt bank reconciliations: (a) reconciliation of items received with items recorded (control totals) = existence/occurrence e.g. bank sends details of each remittance directly to the client for posting to cash and accounts receivable → reconcile with direct deposits by the bank (b) periodic reconciliation of bank statement balance (deposit and cheque in transit) with the balance on the books to identify MM and unusual bank activities (3) Authorization of transactions: (a) only authorized personnel can execute transactions e.g. electronic verification (pw, encryption, cards) or manual (limiting access to area where cheques are signed), (b) any changes to existing bank accounts and opening of new bank account must be authorized and reviewed (4) Pre-numbering: to establish completeness (a) each customer payment is assigned an unique number, which is subsequently entered into system; (b) turnaround documents that customer return with their cash pmts and compare amt indicated with actual remittance (5) Monitoring: (a) daily report of unusual cash activities by location or personnel (detect fraud) (b) review of discrepancies in cash balances from reconciliation (c) report on un-authorized attempts to gain access to cash (6) Periodic IA to determine ctrl effectiveness of cash mgmt

Preliminary ARP to identify potential RMM: (1) Compare monthly cash balances with past years and budgets, identify unexpected spikes or lows in cash (2) compute trends in interest returns on investments to determine whether it is consistent with expected returns (3) compare CFO to sales (CFO/sales),profitability (CFO/NI) *should have (+) correlation, i.e. sales increase, cash sales will increase & prior year CFO (4) If company has debt covenants, check liquidity ratios: Current Ratio (current A / current L) and Quick Ratio (cash + cash equiv + net receivables / current L)

Test of Controls: (1) Select x number of cash receipts (dpds on how frequent ctrl is applied) and ensure that (a) each pmt is given a unique identifier, which is subsequently entered into the system (b) pmts received are the same as the amt applied to the update of AR (how are variances handled?) (c) pmts are segregated into batches for processing (should not leave till mth end) (d) batches are prepared according to coy std. Review the reconciliation of batch controls to det their accuracy and timeliness. (2) Determine who has the authorization to: (a) Make changes in docs or adj when cash amts differ from invoiced amts. (b) Make deposits. (c) Make withdrawals. (d) Make transfers among the org's acc/s or btw the org and other entities → draw sample of e.g. cheque deposits to see if the proper authorized personnel in fact made the deposit (3) Review reports for unusual cash transactions such as transfer of funds to other acc/s, deposits and disbursements not processed through the regular cash process → select a sample of the transactions and review for proper authorization and completeness and correctness of processing.

Substantive Procedures (TOD, usually no sub-ARP e.g. sig fluctuations in cash balances or actual vs. budget variance): (1) obtain bank confirmations – (a) confirm deposit balance; (b) loans and their due dates, i/r pmts, collateral; (c) loan guarantees → ask for loan agreements to identify if org has any debt covenants → affect going concern assumption if can't be met (2) re-perform bank reconciliations: reconciles the balance on bank statements with book balance i.e. agree amts to bank confirmation, subsequent bank statement for deposits or withdrawals in transit, and recorded as per TB (3) bank transfer schedule: Lists all transfers btw company's bank accounts around year end and make sure all transfers are recorded in right period (check for **kiting** i.e. record same cash twice which might be due to fraud by mgmt) → look @ per books date and see if at FYE recorded at 2 different a/cs i.e. **receiving** bank account **recorded** deposit/receipt **before FYE**, **transferor** bank account **recorded** withdrawal/transfer **after FYE**

Acquisition Cycle

For Accounts Payable → Completeness; For Inventory → Existence & Valuation (COGS, factory O/H, inv write-off exp)

Initial Risk Assessment: Inherent Risk: Inventory is usually high inherent risk as: variety of items, high volume of activity, different acct valuation methods, hard to det NRV, identify obsolete inv, easily transportable, stored in >1 locations, need separate process for returned goods

Initial Risk Assessment: Control Risk (1) Requisition for goods and services: depends on manufacturing, retail, JIT, or supplies purchases. Generally: (a) requisition form by e.g. production manager (have authority) forwarded to purchasing dpt, (b) specific dollar limit for e.g. individual buyers or departments, if want to exceed → require approval by manager / supplies purchases (c) computer generated POs to vendors based on inventory levels or production plans → should be based on preexisting contracts + preapproved by mgmt/purchasing dpt (2) Purchase of goods and services: (a) centralized function – promotes efficiency and effectiveness, eliminates potential favoritism that could take place if indiv dpt heads were allowed to place orders, reduces the opportunity for fraud by segregating the authorization to purchase from the custody and recording functions (b) approval of a contract with suppliers (c) restricted access to the computer program (c) monitoring of inventory and purchase levels by mgmt, (d) preventing kickbacks – require competitive bidding; rotating of purchase agents across prdt lines; authorized vendor database (prevent creation of fictitious vendors); (e) pre-numbered POs (contain price, qty, quality → receipt of goods subsequently, and accuracy of vendor's invoice) to establish the uniqueness of each order and completeness of the purchase order population (3) Receipts of goods and services: = when you recognize A/P usually! Uses pre-numbered receiving documents to record all receipts (date, item, quantity, condition) ⇔copy of the PO (usu with quantities blanked out to help assure an indpt count) is reviewed to determine whether a shipment is authorized → establish completeness and cutoff (4) Approval of items for pmts: Three-way match: vendor invoice, purchase order and receiving report → If all matched, approve for payment (validity ascertained) (5) Cash disbursement (a) review of transactions against supporting docs and authorize cash pmt (b) supporting docs are cancelled upon payment to avoid duplication

Preliminary ARP to identify potential RMM: Generally compare with prvs yrs + industry (1) Inventory ratios: (a) Inventory turnover (Days in inventory) → expected to increase if coy intro new prdt with low price pt + high DD, check for obsolescence; (b) Shrinkage ratio (Inventory write down/ending inv) → extent of obsolesce (valuation due to NRV estimate) (c) Inventory per square foot of retail space (for across location comparison) → comparisons made across stores of comparable size/customer DD/ product mix to test for unexpected differences (d) Analyze sales by prdt line and note any sig drop in product line sales, indicate slow moving inv in warehouse → potential obsolece (e) inv aging report for potential superseded prdts (2) A/P Ratios: (a) A/P turnover = (Purchases/Avg A/P) or Days in A/P (b) A/P/Current Liabilities → if biz condition stable, this should be comparable across years (c) Purchase return and allowance/Purchase (area where client can manipulate cutoff on purchase)

Test of Controls: (1) for 3-way match control: take a sample of payments and trace them to the corroborating documentations (vendor invoice, POs, RRs) (2) take a sample of receiving reports and trace through the system to test controls related to the completeness assertion for inventory and A/P (3) checks if signatures are present on the app documentation, and if not, follow up with respb personnel

Substantive Procedures (NB no audit on COGS because = beg inv + purchase - end inv): Inventory & COGS: Existence/Occurrence: (1) Review the client's proposed physical inventory procedures to determine whether they are likely to result in a complete and correct physical inventory (2) Observe inventory stock take and re-perform test count → select randomly high-dollar-value items from client's perpetual inv records **Completeness:** (1) Perform year-end cutoff tests. Select sample from purchase and sales journal before and after year end, vouch against shipping and receiving document to determine proper recording of goods → record right amt of purchase at right period (2) for material items on consignment, either visit location or send confirmation (known via client inquiry) **Rights & Obligation:** (1) review vendor invoices when testing disbursements to determine that proper title is conveyed (2) review purchase contracts to assess rights to return merchandise. **Valuation:** (1) determine if valuation method of inv of client is appropriate (2) Inquire of production personnel about the existence of obsolete inventory (3) note potentially obsolete inventory while observing the physical inventory counts. Trace the potentially obsolete items to the client's inventory compilation and determine whether they are properly labeled as obsolete items (3) test inventory cost by taking sample of recorded inventory and trace to vendor invoices (4) test for the possibility of obsolete inventory (i.e. lower of cost and market price) → inquire of the client about sales adjustment (markdown) that has been offered to sell any product AND verify sale price by reviewing recent invoices (internal) around year end → e.g. **testing value of sold inventory:** agree sales invoice to pmts AND remittance advice from customer + external shipping documents (external needed if potential RMM is high) **Address fraud risk:** alter the timing and extent of the procedures e.g. (a) observe all inv locations simultaneously, (b) confirm invs at locations that are outside the entity (c) send confirmations to vendors confirming invoices and unusual terms

Accounts Payable: Existence/Occurrence: perform a cutoff test of purchases and cash disbursements; **Rights & Obligation:** Review long-term purchase commitments, and determine whether a loss needs to be accrued **Completeness (3 complementary TODs, compare to A/P recorded):** (1) Test for Under Payment: request vendors' monthly statement or send vendors confirmations (2) Test for Paid invoice: draw a sample of cash disbursements made after the end of year to det if they are for goods applicable to the prvs year (**Cutoff**: compare to RR for date received) (3) Test for Unpaid Invoice: draw sample from invoices and trace to A/P (& agree invoice to external shipping documents and terms of trade to see when the pmt should have been recorded – i.e. is it a A/P for the FY?) e.g. **for rent** → obtain official rent contract and det pmt terms in order to det whether pmt relates to FY. Review general ledger to ensure that annual rental expense is consistent with annual amt set out in rental contract **Valuation:** (1) verify accuracy from sub-ledger to ctrl a/cs (2) Request vendors' mthly statement or confirmations (3) 2&3 above

Long-Lived Assets

→ Existence & Valuation (Equipment, dep exp, acc dep, gain/loss on disposal, impairment loss)

Initial Risk Assessment: HIGH Inherent Risk (1) Difficult to ascertain impairment loss → highly subjective & dpt on (a) management incentive i.e. mgmt not interested in writing down assets (b) (impairment loss) determining obsolescence of assets and NRV = difficult to value, requires good judgment & process (2) Incomplete recording of disposal or additions (3) Amortization and depreciation schedules that do not reflect economic impairment or use of assets → mgmt needs to estimate useful life & salvage value **How to ascertain these risks?** (1) Knowledge of the client's business, including industry trends and tech advances (2) Review of various documents, including: (a) business plan for major acquisitions (substantiate for acquisitions later) or changes in the way the company conducts its business (b) major contracts regarding capital investments usually require board approvals → (c) minutes of BOD meetings (d) company filings (company actions, risks, and strategies and plans) **Fraud Risk** : (1) Sales of assets are not recorded and proceeds are misappropriated (2) Sold assets are not removed from book (3) Inapp residual value or lives (4) Costs that should have been expensed are capitalized e.g. lease, repairs & mtce (5) Impairment losses not recognized

Initial Risk Assessment: Control Risk (1) Identify existing assets and reconcile with property ledger on a periodic basis (Existence) (2) Safeguard the assets (Existence) (3) Authorize disposal of assets (Completeness) (4) All purchases are authorized and properly valued (Valuation) (5) Proper classification of new equipment according to its expected use and estimated useful life i.e. part of CGU or individual asset (Valuation) (6) monitor & review asset impairment. (Valuation)

Preliminary ARP to identify potential RMM: (1) Review and analyze gains/losses on disposals of equipment (gains may indicate dep lives are too short; losses the opposite) (2) Compare capital expenditures with the client's capital budget → expectation both will be consistent (3) compare depreciable lives used by the client for various asset categories with those of the industry → large differences may indicate earnings management (4) Compare the asset and related expense account balances to similar items in the prior audit and determine whether the amounts appear reasonable in relation to other information you know about the client e.g. such as changes in operations. (5) Ratios (don't use them if a lot of acquisitions & disposals!) → should be predictable and comparable over time unless change in dep method, basis, or lives A: Ratio of depreciation expense to total depreciable assets. B: Current depreciation expense as a percentage of last-year expense

Substantive Procedures: ARP: Reasonableness test: perform an overall estimate of depreciation expense → e.g. average bal of PPE → adjust salvage value → compute annual dep exp → any material variance from books? If so, check timing of additions/ disposals & recalculate

Substantive Procedures: TOD Existence/Occurrence (1) Inspect tangible assets (2) Select sample from fixed asset ledger and vouch to supporting document (**Addition / Disposal testing**) **Completeness** (1) Review capitalization policy to assure that all significant capital expenditures are capitalized. (2) Review entries to repairs & mtce expense to det whether some items should have been capitalized. (**Addition / Cap vs. Exp testing**) **Rights & Obligations** (1) Inquire of management as to whether long-lived assets have been pledged as collateral → if confirmed, send bank confirmation; if not, → (2) Examine document of title **Valuation & Allocation** (1) Review depreciation/amortization policy and recalculate depreciation/amortization: select sample from FA register → verify cost of asset with vendor's invoice (cost + acq date) → dep policy (confirm useful life & salvage value) → recompute (2) Inquire of management about asset impairment and assess reasonableness of the assessments (**Impairment testing**) (3) Check that detailed fixed asset records are mathematically correct and agree with the general ledger fixed asset accounts (**Roll Forward testing**) *for each class of FA, could have several additions and disposals in the year → make sure they are properly aggregated in the general account **Addition Testing:** select sample from additions/FA register → vouch to invoice (verify existence & cost value) → determine if they are properly authorized and appropriately capitalized I.e. shouldn't be R&M expense **Capitalization vs. Expense Testing:** test R&M expenses to see if they are appropriately expensed or should be capitalized instead → by determining nature of work undertaken (**documents**: client's policy, mgmt reports tell you intention of performing work, engineering assessments tell you the effect of the work on FA, invoice descriptions) → consider frequency of work performed i.e. more frequent = R&M (expense) > improvement (capitalization), result in new asset (capitalization), DEGREE of improvement/ upgrades / value enhancement (dpds), extend useful life (capitalization)

Disposal Testing: select sample from disposals/FA register → vouch to sales invoice (amt for valuation, disposal date for cut-off) → verify sales proceeds to cash receipts/bank statements (substantiate valuation) →recalculate gain/loss from disposal by: (a) vouch cost of asset to original vendor invoice (gives useful life, salvage value and acq date too), (b) re-calculate acc dep, carrying amt, and gain/loss (= sales proceed – carrying amt [original cost – acc dep]) ⇔ gain/loss per GL **Roll Forward Testing:** check DETAILED FA records → beg bal verify with prior year audit → check mathematical calculations i.e. addition / disposals from prvs templates → ending bal ⇔ per books **Impairment Testing:** (1) Impairment indicators = e.g. (a) greater than expected decline in asset mkt values, (b) change in mkt i/r that will affect discount rate to calculate value in use → NRV, (c) evidence of obsolesce or physical damage to an asset (after inspection) → (2) inquire mgmt to see if should impair via CGU or indiv asset → (3) impairment method used by mgmt to determine NRV: higher of fair value less cost to sell = verify the inputs used e.g. indpt sources, and consider if selection is reasonable if there are > 1 alternatives avail in mkt place, OR value-in-use = assess assumptions (supported by ext evidence) if reasonable + test math accuracy of DCF + sensitivity analysis (excel sheet) → (4) compare with client's carrying value → (5) RMM?

Debt Obligations (Bond/Note/Mortgage Payable, i/r exp) **ARP:** (1) Estimated i/r exp based on avg i/r rates and avg debt outstanding (sub ARP) (2) Calculate (a) debt-equity ratios and (b) times interests earned ratio (EBIT/Interest payable) → perform trend analysis with prior years. **TOD: Completeness** (1) Confirm debt obligations with banks/lenders (loan/mortgage/debt), or with transfer agent (public + private)/ buyers (private) (2) Vouch additions and deletions to debt obligations **Valuation** (1) Detailed debt records are math correct and agree with the general ledger debt acc.**(Debt roll forward testing)** (2) Confirm debt obligations and recalculate debt amortization schedule

Equity (Stock a/c [common, preferred, TS], additional paid in capital, dividend, retained eranings) **TOD: Stock Issuance/Repurchase of TS: Existence & Valuation Review board meeting minutes** (1) Confirm with stock registrar and transfer agent on issuance or repurchase (2) For issuance, trace stock proceeds to cash receipts journal.(3) For repurchase, trace repurchase to cash payment journal **Dividend: Existence** (1) Review BOM minutes for authorization of the dividend per share and dividend record date (2) Recalculate the amount of the dividend and agree to cash disbursements journal

SSA560: Subsequent Events

FYE Date →	Director's declaration / FS authorized for issuance + Auditor's report →	Distribution of FS
Time Period 1	Time Period 2	Time Period 3 → …

Subsequent Events: = Time Period 1 i.e. Auditor's responsible for identifying events only for Period 1! + Facts known after auditor's report that would have caused the auditor to amend the auditor's report

Type of Subsequent Events: (1) Adjusting Events: conditions that existed at end of reporting period → (a) FS adjustment or (b) disclosing event e.g. contingent liability in notes to FS (2) Non-Adjusting Events: conditions that arose after reporting date → (a) material, disclose NATURE and ESTIMATE of financial impact of event; (b) non-material, don't need to do anything

Note: to determine if (1) or (2), look at when underlying transaction happened e.g. legal court wrt advert before FYE → (1); for future events, look at when news is made known e.g. for new upcoming tax imposed

Time Period 1: Perform audit procedures for this period, taking into acc its RA (a) obtain an understanding of any procedures mgmt has established to ensure that subsequent events are identified (b) inquire mgmt or TCWG as to whether any subsequent events have occurred which might affect the FS e.g. new commitments/borrowings, increase in capital or debt issuance, agreements to merge or liquidate, any assets appropriated by govt or destroyed by natural causes, contingencies, events concerning recoverability of assets & measurement of provisions/ estimates (c) read minutes, of entity's owners, mgmt, TCWG, held after the date of the FS (d) read entity's latest subsequent interim financial statements e.g. mgmt acc/s (e) read the entity's latest available budgets, cash flow forecasts and other related mgmt reports for periods after reporting date (f) enquire entity's legal counsel concerning litigation and claims; → if material event identified, request coy to make adjustments / consider if these have been appropriately disclosed in FS

Time Period 2 & Time Period 3: auditor no obligations unless fact is made known →then (a) discuss the matter with mgmt & TCWG (b) determine whether the FS need amendment and, if so, (c) inquire how mgmt intends to address the matter in the FS.

If mgmt decides to amend FS → auditor to carry out the relevant audit procedures till the date of new auditor's report and for **Period 3:** also, review the steps taken by management to ensure that anyone in receipt of the previously issued financial statements together with the auditor's report is informed of the situation e.g. recall the FS for revision. **For auditor's report:** if not yet issued to entity, modify opinion & audit report → if issued to entity, notify mgmt to not issue the FS to third parties before the necessary amendments have been made ⇔ issue new or amended auditor's report with an EOM paragraph or Other Matter paragraph referring to a note to the FS

SSA570: Going Concern

obtain sufficient appropriate evidence rgding mgmt's use of going concern assumption → conclude if material uncertainty exists → determine implications for auditor's report

Risk Factors on Going Concern: (1) Financial (a) net liability or net current liability position (b) fixed-term borrowings approaching maturity w/o realistic prospects of renewal or repayment; or excessive reliance on ST borrowings to finance LT assets (c) Indications of withdrawal of financial support by creditors (d) negative CFO indicated by historical or prospective financial statements (e) adverse key financial ratios (f) substantial operating losses or significant deterioration in the value of assets used to generate cash flows (g) arrears or discontinuance of dividends (h) inability to pay creditors on due dates (i) inability to comply with the terms of loan agreements (j) change from credit to cash-on-delivery transactions with suppliers (k) inability to obtain financing for essential new product development or other essential investments.
(2) Operating (a) mgmt intentions to liquidate the entity or to cease operations (b) loss of key mgmt without replacement (c) loss of a major market, key customer(s), franchise, license, or principal supplier (d) labor difficulties (e) shortages of impt supplies (f) emergence of a highly successful competitor (3) Other (a) Non-compliance with capital or other statutory requirements (b) Pending legal or regulatory proceedings against the entity that if successful result in claims that entity cannot satisfy (c) Changes in law or govt policy expected to adversely affect the entity (d) not/underinsured catastrophes when they occur **Additional APs when events are identified to determine if there is material uncertainty:** → has mgmt performed a preliminary assessment of entity's going concern? → if no, discuss with mgmt the basis for going concern and the existence of any conditions + request for them to make assessment; if present → discuss with mgmt and determine whether mgmt has identified events or conditions → evaluate mgmt's plans for future actions in relation to its going concern assessment, and if outcome of these plans is likely to improve the situation e.g. plans to liquidate assets, borrow money or restructure debt, reduce or delay expenditures, or increase capital → other APs incl. mitigating factors: (a) Analyzing and discussing cash flow, profit with mgmt (if there is CF forecast, must first establish that there is adequate support for the assumptions and the underlying data is reliable) (b) Reading terms of debentures and loan agreements to det if they have been breached. (c) Reading BM minutes for reference to financial difficulties. (d) Inquiring of the entity's legal counsel regarding existence of litigation (e) Confirming the existence, legality and enforceability of arrangement to provide or maintain financial support. (f) Confirming the existence, terms and adequacy of borrowing facilities. (g) Determining the adequacy of support for any planned disposals of assets.

Audit Conclusion: (1) going concern app + no material uncertainty = unmodified; (2) going concern app + material certainty = unmodified but with EOM paragraph (if adequate disclosure is made) OR qualified/adverse (if otherwise); (3) going concern not app = adverse

SSA450: Summary of Misstatements

auditors track ALL misstatements identified (material or not), unless clearly trivial i.e. below sum level, and accumulate in SOM → First consider (1) impact on audit: need to change plan or strategy? Need to revise materiality levels? → (2) Impact on FS: (a) if mgmt adjusted, check if correct; if not (b) evaluate if uncorrected misstatements are material = How?

Individually (in relation to particular CLASSES of trans, a/c bal, disclosure) → (a) identify the adjustments required for MMs; (b) identify ALL FS lines affected; (c) choose the SMALLEST line item; (d) calculate % impact and det if MMs are individually material

Aggregate (FS as a whole) → (a) identify which FS line would be affected by > 1 MMs; (b) record the line item amts either as their normal debit / credit and create columns for each of them (c) add up the MM's supposed adj amts as debit / credit (d) calculate %

Need to consider uncorrected MMs from Prior Years: what was understated/ overstated previously? E.g. opening RE ⇔ what is supposed to be recognized this year → adjustments required to bring it to the correct state this year

SSA700/5: Audit Opinion

(1) Unmodified Opinion: FS are prepared, in all material respects, in accordance with the applicable FR framework Reasonable assurance obtained that FS = free from MM: (a) sufficient appropriate audit evidence obtained? FS / a/c (b) are uncorrected MMs material individually or in aggregate (may not be det if lack of audit evidence) (c) FS prepared in accordance to IFRS Other conditions: (d) no sig doubt about client's going concern (f) auditor is indpt (if not, disclaimer)

(2) Modified Opinion: when FS as a whole are not free from MM OR unable to obtain sufficient app audit evidence to say FS is free from MM

	Material but not pervasive	Material and pervasive
FS are materially misstated	Qualified	Adverse
Inability to obtain sufficient app audit evidence	Qualified	Disclaimer

Material MM: (a) Selection of inappropriate acct policy (b) incorrect application of a selected acct policy (c) Inappropriate/ inadequate disclosures
Pervasive: (a) not confined to specific elements, a/c, or items in FS, (b) or if confined, rep substantial proportion of FS, (c) in relation to disclosure, is fundamental to users' understanding of FS **(3) Additional Paragraphs** to either (1) or (2), AFTER forming audit opinion: (a) Emphasis of Matter: relates to understanding of FS by users e.g. material uncertainties in coy's going concern, never use general purpose framework, litigation risks, early app of new acct std with pervasive impact on FS, major catastrophe with sig impact on entity's financial position (b) Other Matters: relate to understanding of auditor's report