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Bachelor of Commerce (B2001) | Level 3 • Part B Major | Monash University

Auditing and assurance

Course Code: ACC3600 • Module 3 Notes

Module 3: Audit Evidence, Sampling & Substantive Testing

Chapter 1: The Nature of Audit Evidence & Financial Statement Assertions (ASA 500)

1.1 Sufficiency and Appropriateness of Audit Evidence

Audit evidence comprises all the information used by the auditor in arriving at the conclusions on which the auditor's opinion is based. Under ASA 500 (Audit Evidence), the auditor must design and perform audit procedures to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions. Sufficiency and appropriateness are interrelated qualities that govern evidence evaluation:

- **Sufficiency (Quantitative Measure):** The measure of the quantity of audit evidence. The quantity of evidence needed is affected by the auditor's assessment of the risks of material misstatement (higher assessed risk requires more evidence) and the quality of such evidence (higher quality evidence may reduce the quantity required). However, merely accumulating a large volume of low-quality evidence does not compensate for poor appropriateness.
- **Appropriateness (Qualitative Measure):** The measure of the quality of audit evidence—specifically, its *relevance* and *reliability* in providing support for the conclusions on which the auditor's opinion is based:
  1. *Relevance:* The logical connection between the audit procedure performed and the specific assertion under consideration. For example, testing the physical existence of machinery by inspecting the physical plant in a factory provides highly relevant evidence regarding the Existence assertion, but provides zero relevant evidence regarding whether the entity actually owns the equipment (Rights and Obligations assertion) or whether the carrying value is impaired (Valuation assertion).
  2. *Reliability:* The degree of trust and credibility that can be placed in a particular piece of evidence, governed by its source, nature, and the circumstances under which it is obtained.

1.2 Hierarchy of Audit Evidence Reliability

Auditing standards establish five fundamental common law and statutory principles regarding the relative reliability of audit evidence:

Reliability Criterion	Higher Reliability Evidence	Lower Reliability Evidence	Operational Audit Example
Source Independence	Obtained from independent external sources outside the entity.	Obtained internally from entity records or personnel.	Direct bank confirmation letter received from an Australian commercial bank vs client-prepared bank ledger printout.
Control Effectiveness	Generated internally under effective internal control systems.	Generated internally under weak, deficient, or bypassed controls.	Sales invoices generated automatically by an ERP with automated price master-file controls vs manual handwritten sales tickets.
Direct Auditor Knowledge	Obtained directly by the auditor through personal physical observation or computation.	Obtained indirectly or by inference from third-party or managerial statements.	Auditor personally attending the physical year-end inventory stocktake vs reading a warehouse manager's written inventory summary.

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Reliability Criterion	Higher Reliability Evidence	Lower Reliability Evidence	Operational Audit Example
Documentary Form	Documentary form (paper, electronic, or other media).	Oral inquiry and verbal representations.	Signed commercial lease agreement specifying contract dates vs verbal statements by the chief operating officer.
Original Documents	Original physical or authenticated digital source records.	Photocopies, facsimiles, or scanned electronic reproductions.	Inspecting original freehold property title deeds vs reviewing unverified photocopied land registry forms.

1.3 The Matrix of Financial Statement Assertions (ASA 315)

Management, in presenting financial statements, makes implicit or explicit assertions regarding the recognition, measurement, presentation, and disclosure of the various elements of financial reports. Auditors use assertions as the foundational framework to categorize potential misstatements and design targeted audit procedures across three distinct reporting categories:

Category	Specific Assertion	Auditor Meaning & Objective	Audit Risk If Violated
Classes of Transactions & Events (Income Statement)	**Occurrence**	Transactions and events that have been recorded have occurred and pertain to the entity.	Overstatement: Fictitious sales booked before year-end; recorded revenue does not exist.
	Completeness	All transactions and events that should have been recorded have been recorded.	Understatement: Unrecorded trade operating expenses or unbooked supplier invoices.
	Accuracy	Amounts and other data relating to recorded transactions have been recorded appropriately.	Computational errors, incorrect pricing, or foreign currency translation arithmetic errors.
	Cut-off	Transactions and events have been recorded in the correct accounting period.	Early revenue recognition (January sales booked in December) or delayed expense recognition.
	Classification	Transactions and events have been recorded in the proper general ledger accounts.	Operating expenses misclassified as capital expenditure (overstating net profit).
Account Balances at Period End (Balance Sheet)	**Existence**	Assets, liabilities, and equity interests exist at the reporting date.	Overstatement: Phantom inventory, bogus debtors, or non-existent bank deposits recorded.
	Rights & Obligations	The entity holds or controls the rights to assets, and liabilities are the obligations of the entity.	Consignment inventory belonging to a supplier included as company asset; unrecorded debt guarantees.
	Completeness	All assets, liabilities, and equity interests that should have been recorded have been recorded.	Understatement: Unrecorded bank loans, omitted trade accounts payable, or hidden lease obligations.
	Accuracy, Valuation & Allocation	Assets, liabilities, and equity interests are included at appropriate amounts, and valuation adjustments are properly recorded.	Overvalued inventory (cost exceeding net realizable value), inadequate expected credit loss reserves, or impaired goodwill.

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Category	Specific Assertion	Auditor Meaning & Objective	Audit Risk If Violated
Presentation & Disclosure (Notes)	**Occurrence & Rights**	Disclosed events, transactions, and other matters have occurred and pertain to the entity.	Disclosing contingent assets or commitments that do not pertain to the legal entity.
	Completeness	All disclosures that should have been included in the financial report have been included.	Omission of related-party transactions (AASB 124) or debt covenant default details.
	Classification & Understandability	Financial information is appropriately presented and described, and disclosures are clearly expressed.	Current debt misclassified as non-current debt (the Centro case failure); obfuscated note disclosures.
	Accuracy & Valuation	Financial and other information are disclosed fairly and at appropriate amounts.	Incorrect financial instrument fair value hierarchy categorizations (Level 1, 2, 3 under AASB 13).

Chapter 2: Audit Procedures & Evidence Gathering Techniques

2.1 The Seven Primary Audit Evidence Procedures

Auditors execute substantive procedures and tests of controls by deploying seven recognized evidence-gathering techniques codified in ASA 500:

1. **Inspection:** Involves examining records or documents, whether internal or external, in paper or electronic form, or physical examination of an asset. Inspection of physical tangible assets (e.g. manufacturing machinery or retail inventory) provides highly reliable evidence regarding Existence, but limited evidence regarding Rights and Obligations or Valuation. Inspection of records involves two directional testing approaches:
    - *Vouching (Testing for Overstatement / Existence / Occurrence):* Selecting an item from the accounting general ledger and tracking it backward to supporting source documents (e.g. tracing a recorded sales entry back to shipping notes, sales orders, and customer contracts). If the supporting document is missing, the recorded entry is fictitious.
    - *Tracing (Testing for Understatement / Completeness):* Selecting a physical source document (e.g. receiving dock goods receipt note) and tracking it forward through the accounting system to the general ledger and financial statements. If the transaction was not recorded, an omission (completeness breach) has occurred.
2. **Observation:** Consists of looking at a process or procedure being performed by others (e.g. observing client personnel conducting physical inventory stock counts or observing segregation of duties in mailroom cash opening). Limitation: Observation provides evidence only at the exact point in time the observation occurs, and client behaviour may alter simply because the auditor is watching (the Hawthorne effect).
3. **External Confirmation (ASA 505):** Audit evidence obtained as a direct written response to the auditor from a third party (the confirming party), in paper or electronic medium. External confirmation is mandatory for bank balances and highly standard for trade accounts receivable, accounts payable, legal claims, and consignment inventory.
4. **Recalculation:** Consists of checking the mathematical accuracy of documents or records (e.g. independently recalculating depreciation expense schedules, lease liability amortisation tables under AASB 16, or foreign exchange translation rates).
5. **Reperformance:** Involves the auditor's independent execution of procedures or controls that were originally performed as part of the entity's internal control (e.g. re-running the automated aged debtors routine or reperforming a bank reconciliation).
6. **Analytical Procedures (ASA 520):** Consist of evaluations of financial information made by a study of plausible relationships among financial and non-financial data, including regression models, ratio trends, and

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predictive reasonableness tests.

7. **Inquiry:** Consists of seeking information of knowledgeable persons, both financial and non-financial, within the entity or outside the entity. Inquiry alone does not provide sufficient audit evidence to detect a material misstatement; it must invariably be corroborated with documentary evidence.

2.2 External Confirmations in Depth (ASA 505)

ASA 505 establishes rigorous protocols governing the design, dispatch, and receipt of third-party external confirmations:

- **Positive vs Negative Confirmations:**
  - *Positive Confirmation Request:* A request that the confirming party respond directly to the auditor indicating whether the confirming party agrees or disagrees with the information in the request, or providing the requested information (e.g. blank confirmation). A positive confirmation provides highly persuasive audit evidence. If the confirming party fails to respond, the auditor must perform alternative substantive procedures (e.g. inspecting subsequent cash receipts post-year-end).
  - *Negative Confirmation Request:* A request that the confirming party respond directly to the auditor only if the confirming party disagrees with the information provided. Negative confirmations provide significantly less persuasive evidence because non-response may simply mean the customer ignored the letter rather than agreed with the balance. Under ASA 505, negative confirmations are permissible only when all four conditions exist: assessed RMM is low, a large population of small homogeneous balances exists, a very low exception rate is expected, and the auditor has no reason to believe recipients will disregard requests.
- **Auditor Control Over Confirmations:** The auditor must maintain strict physical or digital control over the confirmation process: selecting the sample independently, verifying third-party addresses against independent corporate directories, dispatching letters directly from the audit firm, and ensuring responses return directly to the auditor's office or encrypted confirmation platform (e.g. Confirmation.com), never through client management.
- **Management Refusal to Allow Confirmation:** If client management requests the auditor not to confirm a specific bank or debtor balance, the auditor must inquire into management's commercial reasons, evaluate validity, and assess whether the refusal indicates fraud. If the refusal is unreasonable and the auditor is precluded from obtaining sufficient evidence via alternative procedures, the auditor must treat this as a scope limitation, potentially modifying the audit opinion under ASA 705.

Chapter 3: Audit Sampling & Statistical Sample Sizing (ASA 530)

3.1 Statistical vs Non-Statistical Sampling

Audit sampling involves the application of audit procedures to less than 100% of items within a population of audit relevance such that all sampling units have an equal or known probability of selection. ASA 530 distinguishes between two broad sampling paradigms:

- **Statistical Sampling:** Any approach to sampling that involves random selection of sample units and the use of probability theory to evaluate sample results, including measurement of sampling risk. Statistical sampling allows the auditor to calculate mathematically defensible sample sizes, objectively measure sampling risk, and quantify precision intervals.
- **Non-Statistical (Judgmental) Sampling:** Any sampling approach that does not possess both characteristics. While permitted under ASA 530, non-statistical sampling relies entirely on auditor professional judgment and cannot mathematically quantify sampling risk.

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3.2 Sampling Risk and Decision Error Types

Sampling risk is the risk that the auditor's conclusion based on a sample may be different from the conclusion if the entire population were subjected to the same audit procedure. Sampling risk creates two fundamental types of decision errors:

Sampling Error Type	Tests of Controls Context	Substantive Testing Context	Professional & Economic Impact
Type I Error (α Risk)	**Risk of Underreliance:** Controls are assessed as operating ineffectively when in reality they are operating effectively.	**Risk of Incorrect Rejection:** An account balance is concluded to be materially misstated when in reality it is not misstated.	**Audit Inefficiency:** Leads to unnecessary additional testing, expanded sample sizes, wasted auditor hours, and client friction. Does not compromise final opinion validity.
Type II Error (β Risk)	**Risk of Overreliance:** Controls are assessed as operating effectively when in reality they are ineffective.	**Risk of Incorrect Acceptance:** An account balance is concluded to be free of material misstatement when in reality it is materially misstated.	**Audit Ineffectiveness:** The critical danger in auditing! Causes the auditor inappropriately to reduce substantive testing and issue an erroneous unqualified opinion on a fraudulent report, leading to litigation and disciplinary sanctions.

3.3 Monetary Unit Sampling (MUS) Methodology & Mathematical Formulation

Monetary Unit Sampling (MUS)—also known as Dollar Unit Sampling (DUS) or Probability Proportional to Size (PPS) sampling—is the most widely utilized statistical sampling technique in substantive balance testing. Under MUS, the individual monetary dollar within the account balance acts as the sampling unit. Consequently, larger balance ledger accounts (e.g. a customer balance of \$150,000) have an proportionally higher probability of selection than smaller accounts (e.g. \$1,500), automatically stratifying the population toward high-value items.

The statistical sample size n in MUS is determined by the formula:

$$n = \frac{\text{Book Value of Population } (BV) \times \text{Reliability Factor } (R)}{\text{Tolerable Misstatement } (TM) - (\text{Expected Misstatement } (EM) \times \text{Expansion Factor } (EF))}$$

Where the Sampling Interval (SI) is computed as:

$$SI = \frac{\text{Book Value of Population } (BV)}{n} = \frac{TM - (EM \times EF)}{R}$$

Where:

- BV is the total recorded dollar amount of the account population.
- TM is the tolerable misstatement (typically set equal to performance materiality).
- EM is the dollar amount of misstatement the auditor anticipates finding in the population based on prior audits and risk assessment.
- R is the confidence factor (reliability factor) derived from the Poisson distribution corresponding to the acceptable risk of incorrect acceptance (β) and zero expected errors. For a standard 5.0% risk of incorrect acceptance (95% confidence), $R = 3.00$.
- EF is the expansion factor associated with the risk of incorrect acceptance (for 5% risk, $EF \approx 1.60$).

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3.4 Worked Numerical Example: MUS Sample Sizing, Systematic Selection & Error Projection

An audit team tests the Trade Accounts Receivable ledger of Australian Wholesale Supplies Limited at 30 June 2026:

- Total Recorded Population Book Value: $BV = \$12{,}000{,}000$ across 2,400 individual customer accounts.
- Tolerable Misstatement (Performance Materiality): $TM = \$600{,}000$.
- Expected Misstatement: $EM = \$60{,}000$.
- Risk of Incorrect Acceptance: 5.0% (Confidence Level = 95.0%), giving Reliability Factor $R = 3.00$ and Expansion Factor $EF = 1.60$.

Step-by-step statistical computation:

1. **Calculate Statistical Sample Size (n):**

$$n = \frac{\$12{,}000{,}000 \times 3.00}{\$600{,}000 - (\$60{,}000 \times 1.60)} = \frac{\$36{,}000{,}000}{\$600{,}000 - \$96{,}000} = \frac{\$36{,}000{,}000}{\$504{,}000} \approx 71.43 \implies 72 \text{ items}$$

2. **Calculate Systematic Sampling Interval (SI):**

$$SI = \frac{\$12{,}000{,}000}{72} = \$166{,}667$$

3. **Systematic Selection Process:** The auditor generates a random starting dollar number between \$1 and \$166,667 (e.g. \$45,000) using generalized audit software. The auditor then systematically selects every item containing the cumulative dollar: $\$45{,}000$, $\$211{,}667$, $\$378{,}334$, and so on throughout the cumulative debtor list. Any customer account balance exceeding the sampling interval (\$166,667) is automatically selected 100% for testing.
4. **Evaluating Identified Misstatements and Tainting Percentage:** During testing, 71 customer accounts are found to be completely correct. However, one customer account (Customer Account #418) reports an error:
   - Recorded Book Value: $BV_i = \$50{,}000$
   - Audited True Value: $AV_i = \$40{,}000$ (customer returned goods before year-end, unrecorded credit note)
   - Factual Misstatement: $\$50{,}000 - \$40{,}000 = \$10{,}000$ overstatement
   - Tainting Percentage:

$$\text{Tainting } (t) = \frac{\text{Book Value} - \text{Audited Value}}{\text{Book Value}} = \frac{\$10{,}000}{\$50{,}000} = 0.20 \quad (20.0\%)$$

5. **Projected Misstatement (PM):** The projected misstatement across the population generated by this error is calculated as the tainting percentage multiplied by the sampling interval:

$$PM = \text{Tainting } (t) \times SI = 0.20 \times \$166{,}667 = \$33{,}333$$

6. **Calculating the Upper Error Limit (UEL):** The Upper Error Limit represents the maximum potential misstatement in the population at the 95% confidence level:

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> $$\text{Basic Precision } (BP) = R \times SI = 3.00 \times \$166{,}667 = \$500{,}001$$

> $$\text{Upper Error Limit } (UEL) = BP + PM = \$500{,}001 + \$33{,}333 = \$533{,}334$$

7. **Audit Conclusion:** Because the Upper Error Limit ($UEL = \$533{,}334$) is strictly less than Tolerable Misstatement ($TM = \$600{,}000$), the auditor concludes with 95% statistical confidence that the Trade Accounts Receivable balance is not materially misstated.

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Chapter 4: Substantive Audit Programs Across Major Business Cycles

4.1 The Revenue and Collections Cycle (AASB 15)

Revenue is invariably one of the largest and most critical line items on the statement of profit or loss, carrying inherent fraud risk under ASA 240. Under AASB 15 (Revenue from Contracts with Customers), revenue recognition follows a mandatory five-step model: identify the contract; identify performance obligations; determine the transaction price; allocate the transaction price; and recognize revenue when or as performance obligations are satisfied.

A comprehensive substantive audit program for the revenue and collections cycle targets three primary assertions:

- **Occurrence of Revenue:** Mitigating risks of fictitious or premature sales. Key substantive procedures include:
  - Vouching a sample of sales transactions recorded in the sales journal immediately prior to year-end back to signed customer contracts, approved sales orders, customer delivery dockets (signed proof of delivery), and subsequent bank statements showing cash settlement.
  - Performing substantive analytical procedures comparing daily sales volumes for the final two weeks of the financial year against monthly averages; investigating sudden volume surges.
  - Executing automated data analytics to test the entire revenue general ledger for round-dollar manual journal entries or credit notes issued immediately post-year-end that reverse prior sales.
- **Cut-Off of Sales and Receivables:** Ensuring transactions near the balance date are recorded in the correct accounting period. The auditor selects a sample of shipping documents (goods dispatched notes) issued five business days before and five business days after 30 June:
  - For dispatches prior to 30 June: verify that the corresponding sale and cost of sales are recorded in FY2026 and inventory is derecognized.
  - For dispatches after 30 June: verify that no sale is recorded in FY2026 and inventory remains included in the year-end stock balance.
- **Valuation and Allocation of Trade Receivables (AASB 9):** Assessing the allowance for expected credit losses (ECL). The auditor inspects the aged debtors schedule, recalculates aging categorizations (current, 30, 60, 90+ days overdue), reviews historical loss provisioning matrices, examines subsequent cash collections post-balance date, and holds discussions with the credit manager regarding disputed or litigated customer accounts.

4.2 The Purchasing and Payments Cycle: Search for Unrecorded Liabilities

In auditing expenses and trade accounts payable, management faces inherent incentives to understate liabilities and defer operating costs to inflate reported profitability and enhance liquidity metrics. Consequently, the primary audit focus shifts from Existence (overstatement) to **Completeness (understatement)**.

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The cornerstone substantive procedure in this cycle is the **Search for Unrecorded Trade Liabilities** (also known as the search for unrecorded accounts payable):

1. The auditor selects a sample of cash disbursements, electronic funds transfers (EFT), and bank statements for the period immediately following the financial year-end (typically the first 30 to 60 days of July and August).
2. For each post-balance-date payment, the auditor inspects the underlying vendor invoice and goods receipt note (GRN) to determine the exact date the goods were received or services were rendered.
3. If the goods or services were delivered on or before 30 June, the auditor checks whether an accrued expense or trade accounts payable was properly recorded in the general ledger at 30 June.
4. If the liability was omitted from the year-end balance sheet, the auditor logs the unrecorded amount as a factual misstatement on the Summary of Unadjusted Audit Differences (SUAD).
5. Additionally, the auditor inspects unmatched receiving dockets (goods received before year-end for which no vendor invoice has arrived) to verify appropriate accrual.

4.3 The Inventory and Warehousing Cycle (ASA 501 & AASB 102)

Inventory represents an inherently risky asset balance due to its physical tangibility, vulnerability to obsolescence and theft, complex cost accumulation formulas (FIFO or weighted average cost), and multiple geographic storage locations. ASA 501 (Audit Evidence—Specific Considerations for Selected Items) establishes mandatory audit requirements regarding inventory:

- **Mandatory Attendance at Physical Inventory Counting:** Unless practically impossible, the auditor must attend the client's physical inventory stocktake if inventory is material. During the count, the auditor:
  - Evaluates management's counting instructions and procedures for controlling count tags and sheets;
  - Observes the performance of counting personnel to ensure compliance with instructions and verify that damaged or obsolete items are segregated;
  - Inspects the physical condition of stock (identifying dust, rust, damaged packaging, or discontinued product lines indicating impairment); and
  - Performs independent test counts, selecting items from the warehouse floor and tracing them to count sheets (testing Completeness), and selecting items from count sheets and tracing them to physical stock on the warehouse floor (testing Existence).
- **Roll-Forward and Roll-Back Testing:** If the physical count is conducted at a date other than the balance sheet date (e.g. 31 May rather than 30 June), the auditor can rely on the count only if internal inventory controls are effective. The auditor must perform substantive testing on intervening transactions (purchases, sales, production issues) between the count date and year-end to bridge the ledger balance.
- **Lower of Cost and Net Realizable Value (NRV) Testing (AASB 102):** Inventories must be carried at the lower of cost and net realizable value (estimated selling price less costs of completion and disposal). The auditor tests NRV by comparing inventory unit costs against post-year-end sales invoices. If selling prices have fallen below unit cost (due to seasonal clearance, discounting, or technological obsolescence), the auditor requires management to record an inventory write-down.

4.4 The Payroll and Personnel Cycle

While payroll comprises significant operating cash outflows, transactions are generally routine, highly automated, and subject to strict statutory oversight by the Australian Taxation Office (ATO) and Fair Work Ombudsman. Substantive audit procedures focus on:

- **Substantive Analytical Procedures:** Developing an independent mathematical expectation of annual payroll expense by multiplying average employee headcount by average enterprise agreement wage rates, adjusted for annual statutory wage increases, overtime, and superannuation guarantee rate increments (11.5% in FY2025 transitioning to 12.0% in FY2026). If actual expense differs from expectation by more than performance materiality, detailed investigation is required.

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- **Testing for Fictitious ("Ghost") Employees:** Testing segregation of duties between HR personnel who add employees to the master file and payroll staff who authorize payment disbursements. Running data analytics to identify duplicate tax file numbers, identical bank account numbers across multiple employee records, or payments continuing after formal resignation dates.
- **Key Management Personnel Remuneration Testing:** Auditing executive salary, short-term bonuses, termination benefits, and share-based payments (AASB 2) disclosed in the statutory Remuneration Report under s. 300A of the Corporations Act 2001, verifying amounts against board minutes and employment contracts.

Chapter 5: Auditing Accounting Estimates & Related Parties (ASA 540 & ASA 550)

5.1 Auditing Subjective Accounting Estimates and Fair Values (ASA 540)

Modern corporate reporting relies heavily on complex accounting estimates that embody estimation uncertainty, management bias, and subjective fair value assumptions (e.g. discounted cash flow goodwill impairment models, rehabilitation provisions, share option pricing under Black-Scholes). Under ASA 540, the auditor responds to estimation uncertainty by adopting one or more of three substantive approaches:

1. **Testing How Management Made the Estimate:** Testing the operational effectiveness of controls over estimate preparation; evaluating whether the valuation method is appropriate under applicable AASB standards; testing source data integrity; and evaluating whether management's assumptions (e.g. discount rates, terminal growth rates, revenue projections) are reasonable and free from bias when benchmarked against independent economic forecasts.
2. **Developing an Independent Auditor Point Estimate or Range:** The auditor constructs an independent valuation model to evaluate management's estimate. If management's estimate falls outside the auditor's acceptable range, the difference represents a misstatement.
3. **Reviewing Subsequent Events:** Reviewing cash settlements, sales, or disposals occurring between the balance sheet date and the date of the auditor's report that provide conclusive empirical evidence regarding the accuracy of the year-end estimate.

5.2 Auditing Related-Party Transactions (ASA 550 & AASB 124)

Related-party relationships and transactions present heightened fraud risks because they may operate outside normal commercial market forces, creating opportunities for collusion, asset stripping, or undisclosed profit manipulation. Under ASA 550, the auditor must:

- Inquire of management and inspect director interest disclosures, board minutes, shareholder registries, and regulatory filings to identify all related parties and affiliate entities;
- Inspect significant unusual contracts with related entities to evaluate their commercial rationale and determine whether terms are conducted on an arm's length commercial basis; and
- Verify that all material related-party transactions, outstanding balances, commitments, and key management personnel compensations are fully disclosed in the notes to the financial statements in compliance with AASB 124 and Chapter 2E of the Corporations Act 2001.

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Chapter 6: Practical Audit Program Matrix across Business Cycles

6.1 Comprehensive Assertion-to-Procedure Mapping Schedule

To ensure rigorous audit coverage, the table below provides a comprehensive operational mapping linking specific financial statement assertions to inherent risks, automated and manual internal control activities, tests of controls, and substantive audit procedures across core operating cycles:

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Cycle & Account	Target Assertion	Inherent Misstatement Risk	Key Internal Control Activity	Substantive Audit Procedure
Revenue & Receivables	**Occurrence**	Fictitious sales recorded to inflate revenue; unearned revenue booked prematurely.	ERP restricts sales invoice generation until electronic proof-of-delivery (POD) is registered.	Vouch sample of recorded sales to customer orders, shipping notes, signed delivery dockets, and subsequent bank deposits.
Revenue & Receivables	**Cut-off**	July sales recorded in June (pre-closing acceleration) or June credit notes held until July.	Automated daily sequential numbering of dispatch notes with system-enforced date locking.	Compare dispatch note dates 5 days before and 5 days after balance date with sales ledger recording dates.
Purchases & Payables	**Completeness**	Year-end expenses omitted from ledger to artificially increase net operating profit.	Automated three-way matching (PO, GRN, Invoice); monthly supplier statement reconciliations.	Perform search for unrecorded liabilities on post-balance-date disbursements; inspect unmatched GRN log.
Purchases & Payables	**Accuracy**	Incorrect invoice amounts recorded; erroneous VAT/GST input tax credit claims.	Automated system tolerance checks flagging price variances exceeding 1.0% for manager review.	Recalculate invoice mathematical extensions; agree invoice unit prices to approved vendor master-file price lists.
Inventory & Warehousing	**Existence**	Recorded inventory includes phantom items, stolen stock, or double-counted warehouse lines.	Perpetual inventory records updated in real time via barcode scanning; annual physical stocktake.	Attend year-end physical inventory counting; perform test counts from count sheets to physical stock on warehouse floor.
Inventory & Warehousing	**Valuation & Allocation**	Obsolete, damaged, or slow-moving stock carried at historical cost exceeding NRV.	Periodic management inventory aging reviews; automated write-down flags for stock inactive > 180 days.	Compare inventory unit costs to post-year-end selling prices on subsequent invoices (lower of cost and NRV testing).
Cash & Liquid Funds	**Existence & Rights**	Bank balances overstated; unauthorized accounts; unrecorded bank overdrafts or debt liens.	Monthly independent bank reconciliations reviewed and signed off by financial controller.	Obtain direct independent bank confirmation from financial institutions covering all accounts, facilities, and security covenants.

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Chapter 7: Automated Audit Data Analytics (ADA) in Substantive Testing

7.1 The Evolution from Sample Testing to Whole-Population Analytics

The rapid digital transformation of Australian corporate accounting systems has fundamentally altered audit execution. While traditional audit sampling under ASA 530 evaluates a limited subset of items (e.g. 50 to 100 sample transactions) to infer conclusions about the population, modern **Audit Data Analytics (ADA)** leverages high-performance algorithms to inspect, clean, transform, and model 100% of transactions within a data population.

ADA enhances audit quality across multiple operational dimensions:

- **Full Population Testing of Journal Entries (ASA 240):** Rather than sampling a handful of journal entries, ADA tools interrogate the entire general ledger population—often comprising millions of lines. Automated scripts apply multi-criteria filtering to flag transactions that exhibit high fraud risk characteristics:
  1. Entries posted by unauthorized users or temporary administrative accounts;
  2. Entries created at unusual times (e.g. between 11:00 PM and 5:00 AM, or on national public holidays);
  3. Entries with round numbers (e.g. exactly \$500,000) or numbers terminating in "999";
  4. Entries posted directly to revenue accounts with credit entries offset against unusual balance sheet accounts rather than trade receivables or cash; and
  5. Entries posted during the final 48 hours of the financial reporting period that reverse previously recorded operational adjustments.
- **Automated Three-Way Matching:** Data analytics routines ingest purchasing data, electronic goods receipts, and vendor invoices across the entire financial year, automatically executing 100% three-way matching. The software instantly isolates unmatched items, price variances, and duplicate payments for targeted substantive review, eliminating sampling risk.
- **Revenue Realization Analytics:** Linking customer sales invoices directly to electronic dispatch logs and subsequent cash collections to track the complete order-to-cash lifecycle. This enables auditors to detect unusual gaps between invoicing and shipping or identify revenue transactions that lack corresponding cash receipts.

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