SPOTLIGHT ON SPECIFIC AUDIT AREAS

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About this publication

This publication is part of a series which has been developed to assist auditors build the on-the-job skills needed to competently and confidently interact with clients, obtain information in an efficient, professional manner, and escalate relevant information within the audit team.

This publication provides illustrative examples to help auditors understand how to apply professional scepticism in specific audit areas.

The publication is intended to supplement each firm's own training, rather than as a substitute for it. It should be read, and applied, in conjunction with the relevant auditing, accounting, and professional and ethical standards. It provides non-authoritative guidance.

SPOTLIGHT ON SPECIFIC AUDIT AREAS

In order to bring the art of enquiry to life, we have developed the following case studies to demonstrate the types of questions that might be useful in specific audit areas:

1. System changes: revenue system
2. Financial statement disclosures: fixed asset note disclosure
3. Related party disclosures

In the following pages we provide tips and examples of questions that may arise in these audit areas.

When developing your questions it is important that you think about the assertion you are trying to address. You should focus on getting comfort over the key assertions in each of these audit areas.

TIP:

Regardless of the audit area you are working on make sure you use all of your 'fraud finding faculties'. These are:

- **Your nose, for smelling 'something fishy'**
- **Your eyes, for seeing what is in front of you, and what may be on the horizon**
- **Your ears, for listening out for anything that may indicate an issue worth following up**
- **Your mouth, for articulating questions**
- **Your brain, for pulling all the information together**
- **Your gut, to assess whether the responses make sense, and to help you follow your 'gut instinct'.**

For further explanation, watch Wayne Tukiri CA, RSM, explain the use of your fraud finding faculties at www.charteredaccountantsanz.com/fraud

1. CASE STUDY: REVENUE SYSTEM CHANGES

Each financial year the audit team are required to develop an understanding of the clients overall control environment and the systems and processes that are relevant to the audit. The ISAs also require the auditor to evaluate the design of these controls and determine whether they have been implemented[1].

Unless it is a new client, the previous year's audit file should contain documentation of the key systems and controls. A useful starting point is to read through this documentation and then update it through discussion with the client and by looking at other sources of information, such as client documentation and website information.

The assertions relating to revenue are primarily around completeness, accuracy, cut-off and occurrence. These have been summarised below.

Assertions	Revenue example
Completeness	All revenue has been fully accounted for and included in the financial statements.
Accuracy	Revenue has been calculated accurately. Any adjustments at source have been correctly reconciled and accounted for.
Cut-off	Revenue recognised during the period relates to the current accounting period. Any accrued revenue or revenue received in advance has been accounted for correctly in the financial statements (ie appropriately included in debtors or liabilities).
Occurrence	Revenue has been incurred in respect of the entity.
Classification	Revenue has been fairly allocated in accordance with the categories required by the relevant financial reporting framework.

The risk of under or over statement of revenue depends to a large extent on whether the client is incentivised to increase or decrease profit, which will depend on a number of contextual factors. For this reason it is essential that the auditor undertaking the revenue section (and any other audit section for that matter) has a good understanding of the overall business environment the entity is operating in and any incentives that may exist.

BE SPECIFIC – BUT NOT TOO SPECIFIC!

One of the key causes for complaint from clients is being asked the same questions by the audit team year on year. For this reason it is often a good idea to design or frame your questions to reassure your client that you are aware of their previous processes and that you are seeking to confirm whether any changes have been made and identify what these are. For illustration purposes we have provided three possible ways of asking for information to update the revenue system notes. These questions have varying levels of usefulness and are provided as illustrative examples only – you will need to tailor to your clients circumstances. The appropriate question to ask will depend a great deal on the context in which the question is to be asked and the client's individual circumstances.

Example Question	Example Response/Explanation
Do you have any new revenue streams, or ways of earning revenue? **OK**	There is a risk that this question will result in a fairly general response. Your client will likely be aware that the follow up response will require them to describe these new revenue streams to you, and may want to avoid doing so due to time pressures.
Have there been any significant changes in your systems and processes over revenue? **GOOD**	As with the question above there is a risk that the client may find it easier to provide a general response to this question, rather than have to describe any changes to you.
Does [insert staff members name eg Adam] still [insert key control eg reconcile all cash takings for the day to the till]? Have there been any other changes to the way you process and account for revenue or any new revenue streams? **BETTER**	This can be a useful way to frame the question to let the client know that you have read through the prior year process notes, are aware of who previously performed the controls and are looking for the key changes. You will likely need to follow up the response to this initial question with further questions to prompt for other revenue system changes. This question does introduce an element of judgemental bias as it assumes that the control (ie cash takings being reconciled to the till) is still operating. However it may be a helpful first question to set the scene for a conversation about the client's revenue system.

TIP:
Cut-off is often a key risk area relating to revenue as clients may be incentivised to overstate revenue to 'paint a rosy picture' or achieve certain bonus results. The ISAs contain a rebuttable presumption of fraud risk in relation to revenue recognition[2]. What this means is that, unless you can prove otherwise, you must consider there to be a significant risk of fraud in relation to your client's processes for recognising revenue.

[1] ISA 315 *Identifying and assessing the risks of material misstatement through understanding the entity and its environment*, Para. 12–13
[2] ISA 240 *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*, Para. 26

2. FINANCIAL STATEMENT DISCLOSURES: FIXED ASSET NOTE DISCLOSURE

An integral part of an audit is assessing the financial statement disclosures to ensure they comply with the applicable financial reporting standards and are consistent with the audit team's understanding of the client and the knowledge obtained during the audit.

There are four main assertions that relate to the fixed asset area of the audit. These are summarised in the following table:

Assertions	Fixed assets example
Existence	Fixed assets recognised in the balance sheet exist at the period end.
Completeness	All fixed assets that should have been recorded have been recognised in the financial statements. Any fixed assets held by a third party on behalf of the audit entity has been included in the fixed assets balance.
Rights and Obligations	The audit entity owns or controls the fixed assets recognised in the financial statements. Any fixed assets held by the entity on account of another entity have not been recognised.
Accuracy, Valuation and Allocation	Fixed assets have been valued in accordance with the relevant financial reporting standard and not capitalised when they should have been expensed or valued inappropriately.

IS IT READY?

It is (unfortunately) not uncommon for the financial statements disclosures, such as the fixed asset note, to be unavailable or incomplete at the fieldwork stage of the audit. One of the first tasks of the audit should be, therefore, to ask the client for the financial statement disclosures and supporting documentation.

Common questions, responses, and follow up questions, based on a request for the fixed asset note disclosure and supporting work papers, include, but are not limited to:

Example Question	Example Response/Explanation
Can you please send me the fixed asset note disclosure? [These days the client will send most of the work papers through electronically, which will make it easier for you to include in your audit system].	I am still working on it.
Great. When will you be able to send it through? [It is a good idea to get the client to commit to a time, so that you can plan your audit work and make sure you are as efficient as possible].	I will send it through as soon as I can. I can send you the PPE note, or intangible note now, or the fixed asset register, and you can start the audit work off that.
Thank you, but I would prefer to audit the whole fixed asset note disclosure at the same time, as this will be more efficient for both of us. Can you let me know when you will be able to provide it and I will plan my other work around this. [Stand your ground and repeat your request for a timeframe. Explain to the client the benefit to them of you auditing the disclosure once and the downside of auditing incomplete disclosures].	I have already told your supervisor that I am working on these note disclosures as well as the cash flow statement and debtors note. I cannot work on all this at once, I need time and space to get them done. [Take the hint, thank the client, let them know you understand and retreat]. OR; OK, I totally understand. I will send the fixed asset note disclosure through by the end of the day.
[If you are on the receiving end of the first response of the third question, it is probably worth ending the conversation here and escalating the delay in receiving the requested information to your supervisor. Your supervisor can then determine the best course of action to ensure your team has work to do, and the client has the space needed to prepare the work papers. One option may be to 'pull out' of the audit until the financial statement disclosures have been completed].	

3. RELATED PARTY DISCLOSURES

In general, the key audit requirements in relation to related party disclosures are to find out from management the processes for ensuring the:

- identification of related parties; and
- completeness of related party disclosures.

Related parties is often a sensitive area. As such, it is a good idea to escalate any problematic responses received from your client to your supervisor.

The following assertions apply to the audit of the related party disclosures:

Assertions	Related parties example
Completeness	All related parties, related party transactions and balances that should have been disclosed have been disclosed in the notes of financial statements.
Accuracy, Valuation and Allocation	Related party transactions, balances and events have been disclosed accurately at their appropriate amounts.
Occurrence	Transactions with related parties disclosed in the notes of financial statements have occurred during the period and relate to the audit entity.
Classification and Presentation	The nature of related party transactions, balances and events has been clearly disclosed in the notes of financial statements. Users of the financial statements can clearly determine the financial statement captions affected by the related party transactions and balances and can easily understand their financial impact.

WHAT SHOULD I ASK?

The ISAs[3] require the auditor to ask the client about the:

- Processes for **identifying related parties** and transactions with related parties
- **Nature** of the relationship between related parties and the entity
- **Type and purpose** of the transactions with related parties
- Processes for **approving transactions** with related parties or outside the normal course of business
- Whether these transactions were conducted under **normal market terms**

WHO TO ASK?

Key client personnel to ask about related party transactions often extend beyond the finance team and include:

- Corporate Services Manager or equivalent
- Internal auditors
- In-house legal counsel
- Senior management (who may be able to approve significant transactions outside the normal course of business)

As you can see there is often no clear ownership of, or responsibility for, related party transactions and, given the key assertion in relation to related party transactions is completeness, it will generally be necessary to ask management and those charged with governance (TCWG) quite broad questions to identify the existence of these transactions.

Examples of common processes in place to identify related party transactions (which may resonate with your client) include:

- Interests declarations or interest registers
- Conflict of interest processes

Because of the sensitive nature of related party transactions, your client may be incentivised to conceal related party transactions that they may not want disclosed in their financial statements.

Other risks to be mindful of in auditing related party disclosures include the risk of management override of controls. Management override of controls is deemed to be a significant risk on every audit[4]. While the entity may have effective controls in place to identify and approve related party transactions there is a risk that transactions that involve the person responsible for undertaking the identification and approval controls may not be recorded.

[3] ISA 550 *Related Parties*
[4] ISA 240 *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*, Para. 31

TIP:

Be aware of the fraud risk relating to related party transactions. During the Global Financial Crisis and finance company collapses across Australia and New Zealand there were a number of instances where related party transactions had been 'concealed' or inappropriately disclosed.

WHAT TESTS COULD I PERFORM?

There are a number of tests that the audit team can perform to search for related party transactions, such as searching the creditors listing for the names of staff or board members and ensuring that all transactions relate to work known to be assigned to that person. You will probably need to ask your client for access to the creditors listing and/or for the full listing of staff and board members (or to confirm whether board member details provided on your clients website or in the board minutes are up-to-date and correct) to perform these tests.

In the interests of transparency it is normally appropriate to let your client know why you need this information.