
Appendix 2

(Ref: Para. A59, A127 and A135)

Examples of Possible Audit Procedures to Address the Assessed Risks of Material Misstatement Due to Fraud

The following are examples of possible audit procedures to address the assessed risks of material misstatement due to fraud resulting from both fraudulent financial reporting and misappropriation of assets. Although these procedures cover a broad range of situations, they are only examples and, accordingly they may not be the most appropriate nor necessary in each circumstance. Also, the order of the procedures provided is not intended to reflect their relative importance.

Consideration at the Assertion Level

Specific responses to the auditor's assessment of the risks of material misstatement due to fraud will vary depending upon the types or combinations of fraud risk factors or conditions identified, and the classes of transactions, account balances, disclosures and assertions they may affect.

The following are specific examples of responses:

- Visiting locations or performing certain tests on a surprise or unannounced basis. For example, observing inventory at locations where auditor attendance has not been previously announced or counting cash at a particular date on a surprise basis.
- Requesting that inventories be counted at the end of the reporting period or on a date closer to period end to minimise the risk of manipulation of balances in the period between the date of completion of the count and the end of the reporting period.
- Altering the audit approach in the current year. For example, contacting major customers and suppliers orally in addition to sending written confirmation, sending confirmation requests to a specific party within an organisation, or seeking more or different information.
- Performing a detailed review of the entity's quarter-end or year-end adjusting entries and investigating any that appear unusual as to nature or amount.
- For significant and unusual transactions, particularly those occurring at or near year-end, investigating the possibility of related parties and the sources of financial resources supporting the transactions.
- Performing substantive analytical procedures using disaggregated data. For example, comparing sales and cost of sales by location, line of business or month to expectations developed by the auditor.
- Conducting interviews of personnel involved in areas where a risk of material misstatement due to fraud has been identified, to obtain their insights about the risk and whether, or how, controls address the risk.
- Conducting interviews with personnel outside of the financial reporting function, for example, sales and marketing personnel.
- When other independent auditors are auditing the financial report of one or more subsidiaries, divisions, or branches, discussing with them the extent of work necessary to be performed to address the assessed risk of material misstatement due to fraud resulting from transactions and activities among these components.
- If the work of an expert becomes particularly significant with respect to a financial report item for which the assessed risk of material misstatement due to fraud is high, performing additional procedures relating to some or all of the expert's assumptions, methods or findings

to determine that the findings are not unreasonable or engaging another expert for that purpose.

- Performing audit procedures to analyse selected opening balance sheet accounts of previously audited financial report to assess how certain issues involving accounting estimates and judgements, for example, an allowance for sales returns, were resolved with the benefit of hindsight.
- Performing procedures on account or other reconciliations prepared by the entity, including considering reconciliations performed at interim periods.
- Using automated tools and techniques, such as data mining to test for anomalies in a population. For example, using automated tools and techniques to identify numbers that have been used frequently as there may be an unconscious bias by management or employees when posting fraudulent journal entries and other adjustments to use the same number repetitively.
- Testing the integrity of computer-produced records and transactions.
- Seeking additional audit evidence from sources outside of the entity being audited.

Considerations Specific to Public Sector Entities

- Testing whether grants or loans provided to third parties have met the relevant eligibility criteria and have been properly authorised and accounted for by the public sector entity.
- Testing whether write-offs and other adjustments of tax and levy receivable balances or loan balances have been appropriately authorised.

Specific Responses—Misstatement Resulting from Fraudulent Financial Reporting

Examples of responses to the auditor's assessment of the risks of material misstatement due to fraudulent financial reporting are as follows:

Revenue Recognition

- Performing substantive analytical procedures relating to revenue using disaggregated data, for example, comparing revenue reported by month and by product line or business segment during the current reporting period with comparable prior periods. Automated tools and techniques may be useful in identifying unusual or unexpected revenue relationships or transactions.
- Confirming with customers certain relevant contract terms and the absence of side agreements, because the appropriate accounting often is influenced by such terms or agreements and basis for rebates or the period to which they relate are often poorly documented. For example, acceptance criteria, delivery and payment terms, the absence of future or continuing supplier obligations, the right to return the product, guaranteed resale amounts, and cancellation or refund provisions often are relevant in such circumstances.
- Enquiring of the entity's sales and marketing personnel or in-house legal counsel regarding sales or shipments near the end of the period and their knowledge of any unusual terms or conditions associated with these transactions.
- Being physically present at one or more locations at period end to observe goods being shipped or being readied for shipment (or returns awaiting processing) and performing other appropriate sales and inventory cut-off procedures.
- For those situations for which revenue transactions are electronically initiated, processed, and recorded, testing controls to determine whether they provide assurance that recorded revenue transactions occurred and are properly recorded.

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- Examining customer correspondence files at the entity for any unusual terms or conditions that raise questions about the appropriateness of revenue recognised.
 - Analysing the reasons provided for product returns received shortly after the end of the financial year (e.g., product not ordered, entity shipped more units than ordered).
 - Determining whether revenue transactions are recorded in accordance with the applicable financial reporting framework and the entity's accounting policies. For example, goods shipped are not recorded as sales unless there is a transfer of legal title in accordance with the shipping terms especially in circumstances when the entity uses a freight forwarder or a third-party warehouse or fulfillment centre.

Inventory Quantities

- Examining the entity's inventory records to identify locations or items that require specific attention during or after the physical inventory count.
- Observing inventory counts at certain locations on an unannounced basis or conducting inventory counts at all locations on the same date.
- Conducting inventory counts at or near the end of the reporting period to minimise the risk of inappropriate manipulation during the period between the count and the end of the reporting period.
- Performing additional procedures during the observation of the count, for example, more rigorously examining the contents of boxed items, the manner in which the goods are stacked (e.g., hollow squares) or labelled, and the quality (that is, purity, grade, or concentration) of liquid substances such as perfumes or specialty chemicals. Using the work of an expert may be helpful in this regard.
- Comparing the quantities for the current period with prior periods by class or category of inventory, location or other criteria, or comparison of quantities counted with perpetual records.
- Using automated tools and techniques to further test the compilation of the physical inventory counts – for example, sorting by tag number to test tag controls or by item serial number to test the possibility of item omission or duplication.
- Verifying the accurate calibration of tools that are used to record, measure, or weigh the quantity of inventory items – for example, scales, measuring devices or scanning devices.
- Using an expert to confirm the nature of inventory quantities for specialised products – for example, the weight of the precious gemstones may be determinable, but an expert may assist with determining the cut, color, and clarity of precious gemstones.

Management Estimates

- Using an expert to develop an independent estimate for comparison with management's estimate.
- Extending enquiries to individuals outside of management and the accounting department to corroborate management's ability and intent to carry out plans that are relevant to developing the estimate.

Specific Responses—Misstatements Due to Misappropriation of Assets

Differing circumstances would necessarily dictate different responses. Ordinarily, the audit response to an assessed risk of material misstatement due to fraud relating to misappropriation of assets will be directed toward certain account balances and classes of transactions. Although some of the audit

responses noted in the two categories above may apply in such circumstances, the scope of the work is to be linked to the specific information about the misappropriation risk that has been identified.

Examples of responses to the auditor's assessment of the risk of material misstatements due to misappropriation of assets are as follows:

- Counting cash or securities at or near year-end.
- Confirming directly with customers the account activity (including credit memo and sales return activity as well as dates payments were made) for the period under audit.
- Analysing recoveries of written-off accounts.
- Analysing inventory shortages by location or product type.
- Comparing key inventory ratios to industry norm.
- Reviewing supporting documentation for reductions to the perpetual inventory records.
- Performing a computerised match of the supplier list with a list of employees to identify matches of addresses or phone numbers.
- Performing a computerised search of payroll records to identify duplicate addresses, employee identification or taxing authority numbers or bank accounts.
- Reviewing personnel files for those that contain little or no evidence of activity, for example, lack of performance evaluations.
- Analysing sales discounts and returns for unusual patterns or trends.
- Confirming specific terms of contracts with third parties.
- Obtaining evidence that contracts are being carried out in accordance with their terms.
- Reviewing the propriety of large and unusual expenses.
- Reviewing the authorisation and carrying value of senior management and related party loans.
- Reviewing the level and propriety of expense reports submitted by senior management.