

GRANT GAY

ROGER SIMNETT

**AUDITING &
ASSURANCE
SERVICES
IN AUSTRALIA**



7TH EDITION

AUDITING &
ASSURANCE
SERVICES

IN AUSTRALIA

DEDICATION

This book is dedicated to our partners and children, including Gaye, Liz, Sarah, David and Sharina, in appreciation of their continued love and support.

GRANT GAY
ROGER SIMNETT

AUDITING & ASSURANCE SERVICES

IN AUSTRALIA

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FOREWORD

It is with tremendous pleasure that I present the foreword to the seventh edition of *Auditing and Assurance Services in Australia*. This is definitely one of the most widely used and pre-eminent textbooks on auditing and assurance in our region. The authors, Grant Gay and Roger Simnett, are two of the most widely respected and pre-eminent experts on the subject and it is indeed a great honour to be asked to write the foreword for the latest edition.

In the interests of full disclosure, Roger Simnett also happens to be the current chair of the Auditing and Assurance Standards Board (AUASB), who I work for; so, while it might seem obvious I am required to say nice things about Roger and this publication, I can assure readers that its content and quality are first class and an asset to any auditing and assurance professional (student or practitioner).

Since the publication of the previous edition of this textbook in 2015 the pressure on auditors to deliver high quality audits in a challenging marketplace and evolving regulatory environment continues to increase. The demand for different assurance offerings from audit and assurance practitioners is also constantly evolving. These factors, among other things, have driven the need for global and national standard setters, and professional bodies responsible for setting and overseeing auditing and assurance standards, to make numerous improvements to the assurance reporting framework—all of which are covered with distinction in the new edition. This new edition also discusses the practical considerations of these changes, and how they integrate with the existing auditing and assurance requirements, so students can understand not only what the changes are, but why they have been implemented.

The other major change that has occurred across the profession since the last edition was published is the increasing focus on the use of data analytics and the impact of other new technologies on the way audits are performed. This issue has the potential to transform the way audits and assurance engagements are carried out, particularly in respect of traditional auditing techniques like analytical procedures and audit sampling. The authors have provided context throughout this edition on the potential impact new technologies and big data have on the auditing and assurance standards, the audit expectation gap and how audits may be performed in the future.

The seventh edition also represents the first time the new auditor reporting standards, which became effective for years ending on or after 15 December 2016, have been applied. The new requirements for auditor reporting, such as the introduction of key audit matters for listed entities and the amendments to how the audit report is structured, are arguably the most significant changes to what stakeholders will see when it comes to the audit in almost a decade. This edition not only teaches readers about what is different but also researches and analyses the impact for auditors, regulators, clients and other users of the accounts.

In the broader non-traditional assurance space there have been many developments, which are incorporated into this edition. The latter chapters of this textbook address a range of areas where there is an increased demand for different types of assurance engagements, and most importantly how auditors and assurance professionals perform these engagements. There is also great emphasis on how financial reporting requirements and the auditing and assurance standards interact. Both of these topics are examples of where auditing students and scholars of all types need to think pragmatically and responsively as assurance engagements evolve and address the different needs of users as well as the public interest.

Other key topics added in this updated edition include:

- the increased oversight by audit regulators and inspectors, both locally and around the globe, on audit quality findings, and efforts by firms and professional bodies to address the areas of concern raised
- updates made to the ethical code of conduct regarding independence requirements, and the auditor's and assurance professional's responsibilities when it comes to responding to non-compliance with laws and regulations

- the increasingly important role the concept of professional scepticism has both in the auditing and assurance standards as well as how engagements are implemented
- changes made to the auditing standards impacting core concepts such as audit assertions and how the assessment of going concern is made and reported
- important developments impacting requirements and auditing and assurance practice in the internal audit and public auditing sectors.

This new edition of *Auditing and Assurance Services in Australia* retains its place as one of the most valuable and respected references on auditing and assurance for both students and practitioners alike. In my time as an auditing and assurance expert in both the private and public sectors it has been the ‘go to’ source to investigate technical issues or as a guide to develop training materials. Its combination of written content and illustrative examples provide readers with practical and precise guidance on the core principles of auditing and assurance practice, as well as topical and relevant analysis of current and future issues facing the profession.

If there is one thing we know about auditing and assurance services it is that they are constantly changing as markets and regulatory requirements evolve to meet new challenges—but auditing and assurance professionals have proven again and again that they have the ability to make the necessary adjustments, to not only meet these challenges but improve what we do. This textbook is, and will be, a great tool for all current and future auditors and assurance providers. It builds essential knowledge and skills in what is a very interesting and exciting time to be in our profession.

Matthew Zappulla, FCA

Technical Director

Australian Auditing and Assurance Standards Board

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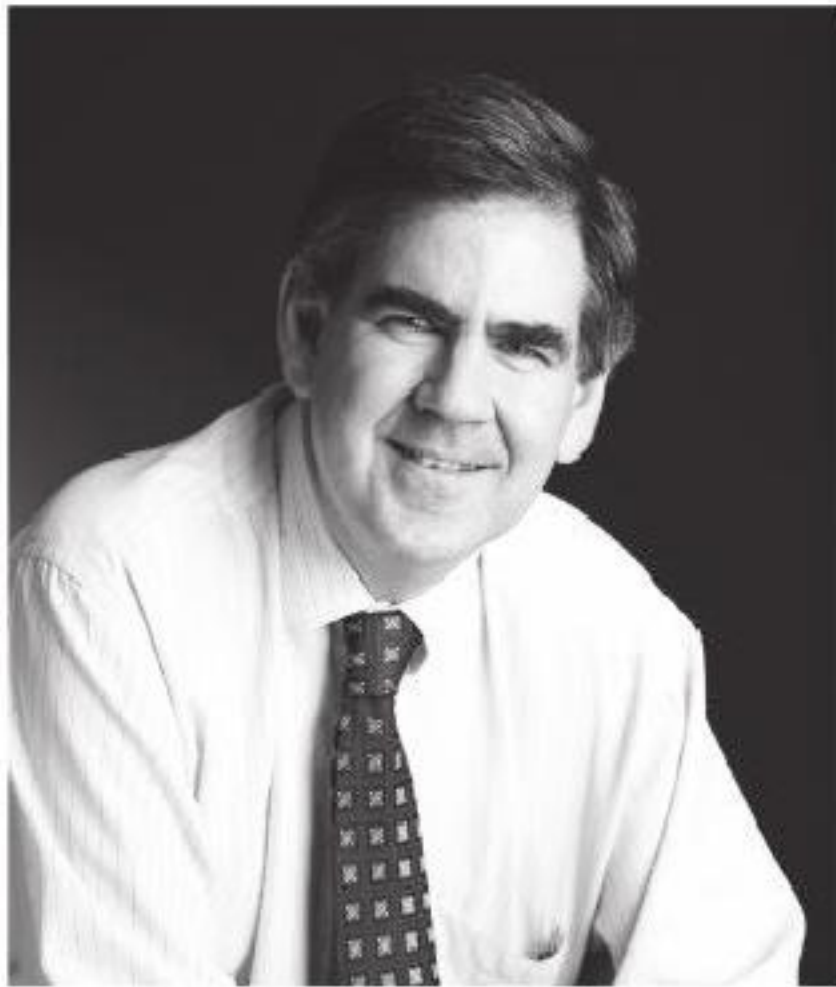
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Sarah is responsible for the thorough updating and revision of the end-of-chapter questions and exercises. She initially spent 10 years in the Victorian Public Service in a variety of financial accounting and audit-related roles, working with a number of Victorian government departments. Sarah has now been working in local government for over 4 years and is currently a Business Coordinator in the City of Casey.

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We especially would like to thank Matthew Zappulla for his kind words in the Foreword. Our thanks to Sarah Hofmann for her invaluable contribution in sourcing and compiling the end-of-chapter questions and exercises, as well as her work on the solutions manual.

Our thanks to the staff at McGraw-Hill Education for all their assistance, in particular Lisa Coady, Dr. Gurdish Gill and Daisy Patiag. Finally, our sincere thanks to our families and colleagues, without whose patience and understanding this book would not have been possible.

MAJOR CHANGES TO THE SEVENTH EDITION

Since the sixth edition was published, a few important changes have occurred as a result of amendments to the auditing standards, other professional pronouncements and ASIC regulations. These changes have been included in the seventh edition, as follows:

- In Chapter 1 consideration has been given to the recent changes in the auditor report and impact on the expectations gap.
- In Chapter 2 consideration has been given to the changes in the auditing standards covering quality control and the need for the auditing profession to improve their performance in this area based on ASIC's inspection program.
- In Chapter 3 consideration has been given to the revised APES 110 issued in 2017 and the impact of NOCLAR on the auditor's duty of confidentiality.
- In Chapter 3, the requirements for an auditor of a public company to resign prior to an Annual General Meeting have been updated for changes made to ASIC's Regulatory Guide 26.
- In Chapter 4 and then throughout the text, the audit assertions have been amended to reflect amendments to the auditing standards in 2015 to condense the previous three categories of assertions into the current two categories. Thus removing presentation and disclosure as a separate category and incorporating the assertions under this category into the remaining two categories.
- In Chapter 4 and then throughout the book, consideration has been given to the impact of advanced data analytics on the audit process and the need for this to be addressed in the auditing standards.
- In Chapter 7 consideration had been given to big data and its impact on the audit.
- In Chapters 8, 9 and 10, increased consideration of new accounting standards and advanced data analytics for tests of controls, substantive testing and auditor sampling respectively.
- In Chapters 11 and 12, the auditor's responsibilities for the appropriateness of the going concern basis have been updated for the amendments to the auditing standards.
- In Chapter 12, discussion of the new audit reporting requirements that have been effective for audits of financial reports for periods ending on or after 15 December 2016, has been updated. This includes enhanced discussion of recent amendments to auditor reporting including Key Audit Matters, enhancing auditor communication, and the auditor's responsibility for other information in the financial report have been expanded, along with the latest information as to how these changes are being implemented, and potential impacts.
- In Chapter 13, updated discussion of limited assurance, effectiveness of Internal control, environmental and sustainability assurance, greenhouse gas statement assurance and e-commerce, including blockchain.
- In Chapter 14, the discussion has been updated for changes in the internal audit standards and surveys of current practice.
- In Chapter 15, the discussion of performance engagements and compliance engagements has been updated for changes in the revised ASAE 3500 and ASAE 3100.
- Throughout the text, references to paragraphs within the auditing standards have been updated to the new paragraph references in the amended auditing standards in effect at 1 January 2018.
- New "Auditing in the global news" features have been included in each chapter.
- End-of-chapter questions, discussion problems and case studies have been extensively replaced.

CHAPTER 1 Assurance and auditing: an overview

- updated for changes to the assurance framework and enhanced discussion of new assurance services
- closer linking of the learning objectives on attributes of accounting with demand for assurance
- updated the discussion on the audit–client–public relationship with the recent expectation gap discussion related to auditor reporting
- streamlining of the section on the evolution of the audit function

- updated the section on the expectation gap, including reference to the information gap and also to the communications gap

CHAPTER 2 Audit regulation, structure of the profession and auditor's liability

- updated discussion of AUASB to include consideration of AUASB strategy document
- included discussion of Monitoring Group discussion paper on suggested changes to international auditing standard setting process

- updated discussion of Companies Auditors Disciplinary Board for change of name and application now only to auditors
- increased discussion on the need for auditors to improve their quality based on ASIC audit inspections
- updated audit quality discussion to reflect revised ASA 220 and revised ASQC 1 issued in May 2017

CHAPTER 3 Ethics, independence and corporate governance

- updated discussion of independence for the amendments to APES 110 issued in September 2017
- included discussion of responding to non-compliance with laws and regulations (NOCLAR) and its impact on an auditor's duty of confidentiality
- updated the requirements necessary for an auditor of a public company to resign prior to an Annual General Meeting due to changes made to ASIC's Regulatory Guide 26
- updated audit firm rotation material for implementation of EU legislation in 2016

CHAPTER 4 Overview of elements of the financial report audit process

- expanded the discussion of professional scepticism and professional judgment and increased the emphasis on their importance
- expanded discussion of electronic information, including advanced data analytics
- the audit assertions have been amended to reflect amendments to ASA 315 issued in December 2015 to condense the previous three categories of assertions into the current two categories. Thus removing presentation and disclosure as a separate category and incorporating the assertions under this category into the remaining two categories
- updated discussion of materiality for the requirements of the revised ASA 450 issued in May 2017 and AASB Practice Statement 2 issued in December 2017

CHAPTER 5 Planning, understanding the entity and assessing business risk

- discussed how advanced data analytics can assist the auditor in understanding the entity

CHAPTER 6 Assessing inherent risk and other specific business risks

- updated fraud requirements for revised ASA 240 issued in May 2017
- discussed impact of advanced data analytics on fraud detection
- discussed impact of NOCLAR on fraud reporting

- updated reporting of illegal acts requirements for revised ASA 250 issued in May 2017

CHAPTER 7 Understanding and assessing internal control

- discussed big data and the use of advanced data analytics on large populations

CHAPTER 8 Tests of controls

- improved discussion of specific instances of control environment
- reduced the discussions of basic controls in a sales cycle and expenditures cycle; these higher level controls are well discussed at a more generic level in the chapter
- updated control environment to reflect move away from documents to electronic transactions, including impact of data analytics on tests of controls
- added discussion on auditor response if the test of controls suggests that the control is not working
- reduced general discussion around primary control-related functions
- deleted the section on advanced CAATs; this included audit hooks, snapshots, etc.

CHAPTER 9 Substantive tests of transactions and balances

- updated the guidance on bank confirmation requests, from AGS 1002 to GS 016
- revised each of the areas of substantive testing to make procedures more concise and use more specific examples of substantive testing
- updated discussion on different transactions and account balances to reflect increased emphasis on electronic accounting systems and transactions
- updated discussion of changes in accounting standards and auditing of fair value and impairment
- increased discussion on advanced data analytics for substantive testing
- increased reference to use of Excel as an audit software technique

CHAPTER 10 Audit sampling

- greater linking of attribute sampling techniques with tests of control (Chapter 8) and dollar unit sampling to substantive testing (Chapter 9)
- synthesised discussion of definitions and features of audit sampling
- enhanced discussion on evaluating sample results
- enhanced discussion of data analytics and relationship with audit sampling
- removal of the appendices on evaluation of sample results using statistical techniques

CHAPTER 11 Completion and review

- updated the auditor's responsibilities for the appropriateness of the going concern basis due to amendments to ASA 570 in December 2015

CHAPTER 12 The auditor's reporting obligations

- significantly updated to reflect the recent changes to the auditor's reporting requirements to enhance communication effectiveness
- enhanced discussion of the reasons for enhancing auditor report communications in the current environment
- updated discussion on types of audit reports issued in Australia
- updated for auditor's responsibilities for other information contained in an annual report

CHAPTER 13 Other assurance services and advanced topics

- updated for the revised ISAE 3000 *Assurance Engagements other than Audits or Reviews of Historical Financial Information*
- updated for the revised Assurance Framework
- updated for GHG assurance and changes, including reference to GS 021 *Engagements Under the National Greenhouse and Energy Reporting Scheme, Carbon Pricing Mechanism and Related Schemes*
- updated the material on environmental and sustainability, including 2017 KPMG survey
- updated for ASAE 3450 *Assurance Engagements Involving Corporate Fundraisings and/or Prospective Financial Information*

- updated for ASAE 3610 *Assurance on General Purpose Water Accounting Reports*
- updated for the revised ASRE review engagement suite
- updated for the changes to the agreed-upon procedures standards (ASRS 4400)
- updated discussion on e-commerce, and included small discussion on blockchain
- updated to reflect latest developments on Standard Business Reporting

CHAPTER 14 Internal auditing (online)

- updated for changes in internal audit standards
- updated for surveys of current practice of internal audit
- updated for the COSO framework changes, including ERM COSO strategy 2017,
- inclusion of table and enhanced discussion of comparison between internal audit and external audit
- updated discussion of the activities of the Institute of Internal Auditors
- enhanced discussion and examples of internal audit
- included a discussion on Internal audit, data analytics and cybersecurity

CHAPTER 15 Audit and assurance services in the public sector (online)

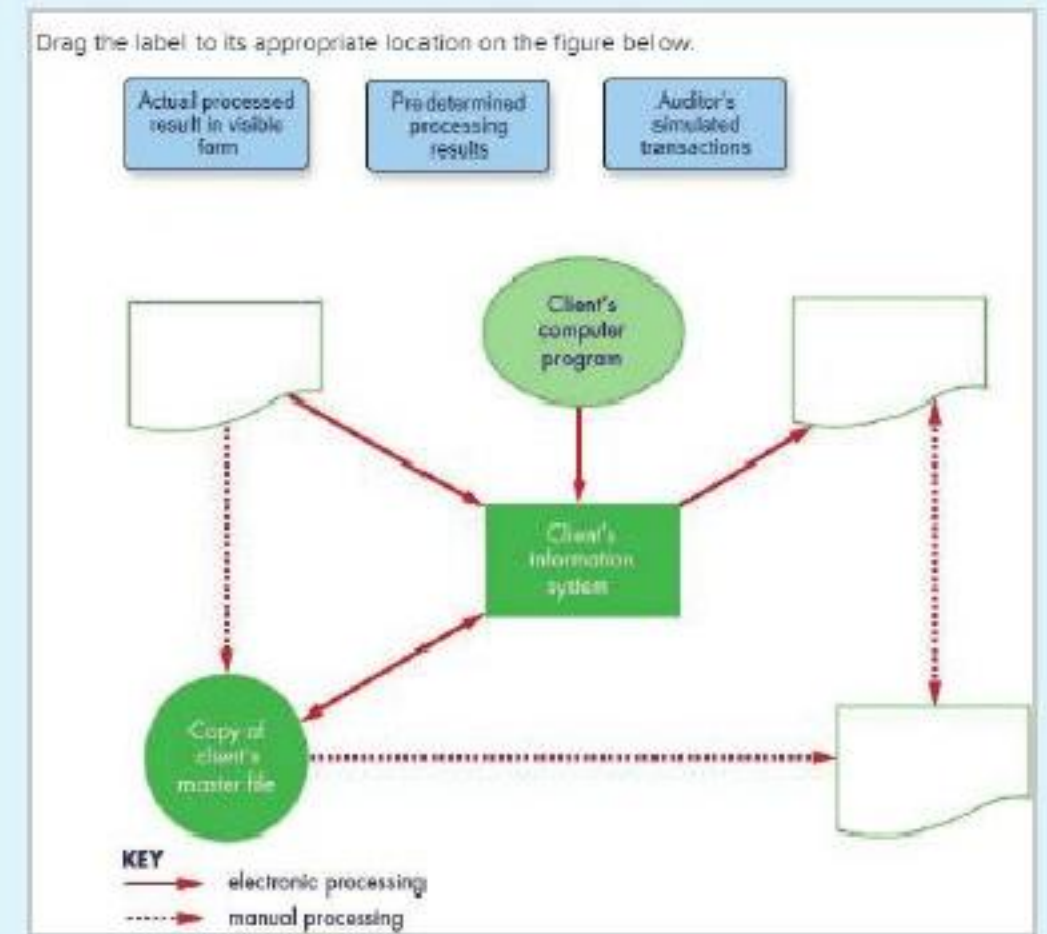
- revised coverage of performance engagements and requirements of revised ASAE 3500 issued in October 2017
- increased discussion of compliance engagements and requirements of revised ASAE 3100 issued in February 2017
- updated discussion of the ANAO

DIGITAL RESOURCES

This text comes with McGraw-Hill Connect—a digital teaching and learning environment that responds to contemporary students' needs. Connect brings a variety of learning resources that accompany this text together in one place, and can also integrate and interact with your LMS. Connect allows instructors the opportunity to provide a blended learning approach to their teaching.

Interactive end-of-chapter questions

A selection of activities from the end of each chapter have also been specially built as interactive questions to allow students to practise what they are learning in a responsive environment that caters to every learning style. These include a range of drag-and-drop questions and worksheet questions.



Case studies

Connect also provides a series of case study-type questions. The continuous case study from the text has been built as an interactive, fully-digital case study inside Connect. Additionally, a range of online-only cases of auditing scenarios as well as comprehension cases (stepped out for students) have also been provided. Designed to replace the static experience of printed case study companions, these online cases allow students to better understand audit principles as they are couched in “practice-oriented” learning opportunities.

Auditing the automated recording processes

Robyn Dyt, Monash University

Harry's Ceramic Importers (HCI) imports boutique and everyday homewares and sells them to large chain-store retailers. HCI has adapted their processes to respond to the many changes within their operating environment. To allow HCI to grow while keeping strong control over their costs, the board of HCI has developed a number of policies and procedures and installed e-commerce operations and software packages to automate and integrate as much of their operations as possible. HCI has an audit committee and an internal audit department.

The internal audit team has reviewed a number of departments and their working papers reflect the following:

- HCI requires the human resources team to undertake qualification and prior period employment checks when recruiting new employees. Further, candidates are required to undertake personality profiling for matching to the HCI culture. Only candidates who successfully meet all employment criteria will be offered employment.
- Supplier checks are conducted and HCI will only transact with businesses which engage in sustainable and environmentally sound processes. The merchandise team spend considerable time seeking new suppliers which meet the company's high standards. When the merchandise team find new potential suppliers with very saleable sustainable and environmentally sound products their details are submitted to the merchandise manager and CEO for approval. If approved these suppliers are added to the list of accredited suppliers and supplier agreements are entered into. Supplier agreements set out the agreed contracted price for each inventory or purchase item, supply terms and conditions, delivery and payment terms. Upon the finalisation of the supplier agreements, electronic document interchange (EDI) arrangements connecting HCI computer systems to supplier systems using appropriate firewalls are made to allow direct ordering, receipting and payments.
- The procurement team (purchasing team) makes all orders online via EDI arrangements, selecting items directly from suppliers' sites and creating purchase order requests in the HCI computer system. The merchandise manager receives a daily report of all purchase orders and reviews these and then authorises the purchases they agree with. A purchase order is then automatically sent to the supplier detailing the items required, the quantity and price for each order. This information is subsequently used to match with the goods received. Again the merchandise manager receives a daily report of all items received which has been automatically matched to purchase orders and an exception report for any variations. All variations on the exception report are followed up with the supplier. The automated system provides the accounts payable officer a daily report of all items purchased and received, and the amounts due for payment. Since all purchases have been authorised by the merchandise manager (purchase and receipt), this provides payment authorisation and so all payment information is included for the next payment run. This ensures prompt and accurate payments with minimum processing costs and does not require any paper invoices or supplier statements. It automates the procurements process.

Assessment content and instructor support

Connect also houses a range of assessment content in the form of testbanks and quizzes to facilitate and provide formative and summative learning opportunities. Instructors are further supported with an Instructor Resource Manual and PowerPoints to deliver each lesson effectively.

14

Testing from a sample of vouchers helps to determine whether associated entries are recorded in the cash receipts journal. Which of the following applies to cash?

Multiple Choice

- Comparison
- Debitwise
- Rights and obligations
- Assets, liabilities and elements



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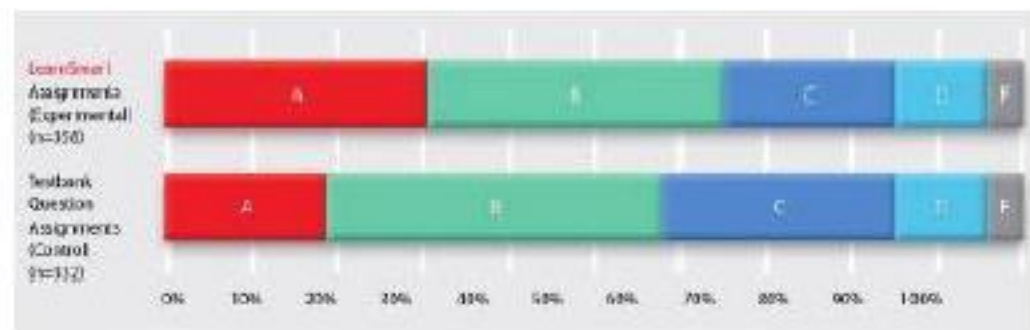
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Connect provides you with reports to help you identify what you should study and when your next assignment is due, and tracks your performance. Connect's Overall Performance report allows you to see all of your assignment attempts, your score on each attempt, the date you started and submitted the assignment, and the date the assignment was scored.

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HOW TO USE THIS BOOK

PART OPENER

GRADUATE SPOTLIGHT



NAME: PRAKASH RAJANDRAN
Degree studied: Bachelor of Commerce (Accounting & Finance)
University: Curtin University of Technology, Western Australia
Current position: Head of Risk and Insurance
Employer: LINX Cargo Care Group (primarily owned Brookfield – Global Alternative Asset Manager)

What interested you about working in auditing?
 Specifically, this role allows me to be exposed to the development of the business strategy and roll-out of new initiatives by ensuring those programs can be sustainable and scalable. Auditing allows me to work closely with the business leaders to help understand its challenges and help shape the future of the organisation. For example, the success of the company is about driving the right behaviours to complement the systems and processes in play. The behavioural auditing programs that I have championed allow me to flush out the behaviours that are not aligned to the values of the business. In short, working the auditing space helps me play a critical role in making a business achieve its strategic goals.

What did you learn in your degree that has been most useful in your career?
 The degree gave me a good understanding of the basic concepts. Examples are controls, systems and processes important in the ecosystem of an organisation.

What have you been up to since graduation?
 On graduation I worked for the global accounting firm EY, both in Malaysia and Australia. I started off in the assurance function and then branched out into advisory (internal auditing and process improvement). During my tenure at EY, I worked across different industries, including Financial Services, Manufacturing, Mining, Public Sector and Services. I then set up the Internal Audit function of Asciano Limited. In 2016, Asciano was partly acquired by Brookfield Infrastructure Partners (NYSE-listed organisation/Global Alternative Asset Manager), and I was then offered the role to lead the Risk and Insurance function of the newly-established business (LINX Cargo Care Group).

What does your current job/position involve?
 I am establishing the Enterprise Risk Management framework, the Anti-Bribery and Corruption Program, and the insurance strategy (including presenting to the insurance markets as part of the annual insurance renewal program). I am also working with the Legal and Operational functions to ensure contracts and initiatives have robust risk management practices.

What do you enjoy most about your work?
 I worked closely with the senior leadership team to help make the business better (by rolling out new programs of work to drive optimal behaviours, improve competitiveness of the organisation, etc.) and keep them out of trouble (ensuring non-compliance is thoroughly investigated and addressed so it doesn't repeat itself and/or manifest into a bigger issue).

What advice would you give prospective students who want to pursue a career in auditing?
 During the summer breaks, try and land an internship with one of the accounting firms, as the experience interns gain can put a lot of concepts they have studied at university into perspective.

What are your thoughts on the future of the auditing industry?
 Auditing should be a strategic function of the organisation. This is because it plays a critical part in the ecosystem of an organisation. However, more work is required to educate business leaders on the true value of the auditing function and how a greater focus and investment in this function can generate dividends for the organisation.

Graduate spotlights

Each part opens with an introduction of the key concepts and issues that will be discussed and now includes a new Graduate Spotlight feature. Each Spotlight features an auditor working at real companies and sharing their experiences and advice on the field of auditing.

CHAPTER OPENER

LEARNING OBJECTIVES (LO)

- 1.1 Understand the framework for assurance engagements and the types of assurance engagements that can be provided.
- 1.2 Define auditing and appreciate the fundamental principles underlying an audit.
- 1.3 Appreciate the attributes of accounting information and understand the reasons giving rise to demand for assurance and resulting benefits.
- 1.4 Explain the concept of the expectation gap, especially in the areas of auditor's report messages, corporate failures, fraud and communicating different levels of assurance, and appreciate the relationships between the auditor, the client and the public.
- 1.5 Appreciate the role of auditing standards and their authority under the *Corporations Act 2001*.
- 1.6 Obtain an overview of other applications of the assurance function, including compliance engagements, performance engagements, comprehensive engagements, internal auditing and forensic auditing, as well as of providing assurance on subject matter other than historical financial information.

Learning objectives

Every chapter opens with a clear set of learning objectives telling you what you should be able to do after you have finished reading that chapter. These learning objectives are also displayed in the margin alongside the section of the chapter that provides this knowledge and skills.

RELEVANT GUIDANCE

ASA 200/ISA 200	Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Australian (International) Auditing Standards
ASA 240/ISA 240	The Auditor's Responsibilities Relating to Fraud in an Audit of a Financial Report
ASA 250/ISA 250	Consideration of Laws and Regulations in the Audit of a Financial Report
ASA 315/ISA 315	Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment
ASA 330/ISA 330	The Auditor's Responses to Assessed Risks
ASA 550/ISA 550	Related Parties
ASA 570/ISA 570	Going Concern
AASB 124/IAS 24	Related Party Disclosures
APES 110/IFAC	Code of Ethics for Professional Accountants

Relevant guidance

Both Australian and international auditing and assurance standards and other guidance relevant to topics covered are listed at the start of each chapter.

CHAPTER OUTLINE

Although a financial report audit is only one type of assurance engagement, it is the most common. Therefore, in this chapter an overview of the elements of the financial report audit process is provided.

While a financial report audit of a complex entity is a complicated process, even the most complex audit has certain basic elements. This chapter compares financial report auditing with accounting and explains the basic elements of the audit process, including professional scepticism and professional judgment. These building blocks are necessary to understand how an audit is accomplished in conformity with Australian auditing standards. Most of the auditor's work in forming an opinion on the financial report consists of obtaining and evaluating evidence about the assertions in the financial report by applying auditing procedures. It is important to understand each of the elements—audit evidence, materiality, assertions and audit procedures—in order to comprehend the audit of a financial report, which will be conducted within the framework of the audit risk model and the client's business risk.

The auditor must also prepare and maintain adequate audit working papers to document their work. This chapter explains the function and content of audit working papers.

How this chapter fits into the overall financial report audit is illustrated in Figure 4.1, which is an expansion of part of the overall flowchart provided in Chapter 1.

Chapter outlines

Each chapter starts with an overview of the material to be covered, placing it in context with current Australian and international practice, including flowcharts to illustrate the steps in the audit and assurance process.

CHAPTER BODY

Earnings management occurs when judgment in financial reporting and in structuring transactions is used to alter financial reports to influence the perceptions of stakeholders about the underlying economic performance of the company or to influence outcomes that depend on reported accounting numbers. Earnings management affects the transparency of underlying economic reality and stakeholder decisions in the allocation of scarce resources. Incentives for earnings management may be classified as either behavioural or market-based.

Behavioural incentives include:

- political considerations to avoid regulation or enhance eligibility for concessions
- executive remuneration based on financial or share price performance
- discretionary transactions over which there is ambiguity or flexibility within accounting standards or where no accounting standard exists

Earnings management
When judgment in financial reporting and in structuring transactions is used to alter financial reports to influence the perceptions of stakeholders about the underlying economic performance of the

QUICK REVIEW

1. *Inherent risk is the risk of misstatement arising from the characteristics of the entity and the environment and industry in which it operates.*
2. *Inherent risk needs to be considered as part of the planning process because it affects other decisions made at this time.*
3. *Inherent risk must be assessed both at the financial report level and at the assertion level.*

Key terms and margin definitions

Key terms are highlighted and defined in the margin. These terms are also listed at the end of the chapter and the definitions repeated in the end-of-book glossary. Designed for easy access, they are a useful tool for exam revision.

Quick reviews

At the end of each section of the chapter, a set of points summarises the key concepts to be taken from that section. These are the essential takeaway points for exam revision.

Global examples

Worked and illustrative examples explain the theory and show their relevance to real-world situations.

GLOBAL EXAMPLE 6.2 Drivers of fraud

Facts

Peter Ebert is the owner-manager of a kitchen renovation business. His friend Jack has asked him to renovate his kitchen and has offered to pay cash for a good price as he can't afford the full retail price. Jack says that Peter can do it off the books, as Jack doesn't need any paperwork and then Peter doesn't need to include it in his taxable income.

Pressure or incentive

Peter is being pressured by a friend and has the incentive to reduce taxes he would otherwise have to pay.

Opportunity

As the owner-manager of the business, Peter is able to override any controls and not record the revenue in the company's books.

Rationalisation

Peter may be able to justify this deal to himself by saying that he is just helping out a friend and that he already pays too much tax and lots of other people do the same thing in the cash economy.

Auditing in the global news

News items and snippets impacting on auditing highlight the relevance of chapter topics to events in auditing.

6.1 Auditing in the global news . . .

KPMG survey reveals surge in fraud in Australia

KPMG's latest six-monthly Fraud Barometer shows a large rise in the value of fraud being committed in Australia. For the period April 2016 to September 2016, the total value of frauds rose by 16 percent to a total of \$442m, from \$381m in the previous six month period—although average value per fraud fell slightly, from \$3.3m to \$3.1m.

Frauds perpetrated by professional criminals notably rose by 300 percent—although the majority of frauds are still carried out by company insiders—with technology playing an increasing role.

Gary Gill, Head of Forensic at KPMG Australia, said: 'Our Barometer shows that fraud continues to rise relentlessly in Australia . . .'

Exhibits

These provide you with examples of typical and actual documentation—such as standard letters of appointment, ASX listing rules and standard guidelines.

EXHIBIT 4.2		THE INTERRELATIONSHIPS OF THE COMPONENTS OF AUDIT RISK			
		Detection risk matrix			
		Assessment of control risk			
		High	Medium	Low	
Assessment of inherent risk	High	Low	Low	Medium	
	Medium	Low	Medium	High	
	Low	Medium	High	High	

END-OF-CHAPTER

Chapter summaries

These summaries are an excellent pre-exam revision tool, giving you a concise summary of the main points from that chapter.

Summary

A major component of audit risk is inherent risk, which is the risk of errors occurring due to the characteristics of the entity and the environment in which it operates. Special risk areas that need to be considered are fraud, including earnings management; related-party transactions; and the appropriateness of the going concern basis for preparing the financial report.

Comprehensive end-of-chapter questions

Grouped by topic and linked directly to the chapter learning objectives, these problems and questions give you an opportunity to test how well you've understood the chapter topics.

Review questions

Inherent risk

- 6.1 Define inherent risk and explain why it is important to evaluate inherent risk as part of audit planning. **LO 6.1**
- 6.2 Outline the factors that may influence inherent risk of the financial report level. **LO 6.1**
- 6.3 Outline the factors that may influence inherent risk at the assertion level. **LO 6.1**

Risk of fraud

- 6.4 What are the ways in which fraudulent financial reporting may be achieved? **LO 6.2**
- 6.5 Describe three types of enquiry that an auditor will make of management with regard to fraud. **LO 6.2**
- 6.6 What impact will advanced data analytics have on fraud detection? **LO 6.2**

Continuous case study

Background information for the continuous case study, Reliable Printers Ltd (RPL), is contained in the Appendix to this book.

- 6.28 **EASY** You are conducting your risk assessment of RPL ~~as part of the planning for your audit for~~ the year ended 30 June 2018.

REQUIRED

Based on the background information for RPL contained in the Appendix, identify two inherent risk factors that arise from the nature of RPL's business operations. Explain why each of these is a risk and how it may affect the risk of material misstatement in the financial report. **LO 6.1**

Source: This question was adapted from the Chartered Accountants Program of the Institute of Chartered Accountants in Australia, 2012 (3) audit and assurance module.

- 6.29 **MEDIUM** As part of your audit of RPL for the year ended 30 June 2018, you are considering the risk that fraud may have occurred.

REQUIRED

(a) Based on the background information for RPL contained in the Appendix, identify and explain two key fraud risk factors relating to misstatements arising from fraudulent financial reporting to which RPL may be susceptible.

(b) Explain how the risk factors identified in (a) would affect the conduct of the audit. **LO 6.2**

Source: This question was adapted from the Chartered Accountants Program of the Institute of Chartered Accountants in Australia, 2012 (3) audit and assurance module.

Continuous case study

A continuous case study can be found at the end of Chapters 4 to 12. In this case study, you can follow the various decision-making points of one company as it proceeds through the financial report audit process. This continuous case study is supported by substantial background information on the company in the Appendix. The entire case study has also been built as an interactive, fully-digital case study in Connect.

PART 1

The auditing and assurance services profession

This part of the textbook introduces the concepts of auditing and assurance services and explains the relationship between them. It outlines recent developments arising from the assurance framework adopted by the International Auditing and Assurance Standards Board (IAASB) and the Australian Auditing and Assurance Standards Board (AUASB), with particular emphasis given to recent developments relating to audit engagements (providing reasonable assurance) and review engagements (providing limited assurance) of financial reports.

Part 1 also recognises that audits of financial reports are extremely important, since they are the primary service on which the profession has developed its reputation. It also outlines the major influences in society that give rise to a demand for auditing and assurance services. It further considers other influences on the environment associated with assurance service providers, including the internationalisation of auditing, the development of industry specialisations by audit firms, the roles played by the corporate governance structure within organisations and the ethical rules and ethical decision-making models associated with the auditing profession. This textbook incorporates the recent changes to the international and Australian auditing and assurance standards that apply to audits beginning on or after 1 January 2018.



GRADUATE SPOTLIGHT



NAME: PRAKASH RAJANDRAN

Degree studied: Bachelor of Commerce (Accounting & Finance)

University: Curtin University of Technology, Western Australia

Current position: Head of Risk and Insurance

Employer: LINX Cargo Care Group (primarily owned Brookfield – Global Alternative Asset Manager)

What interested you about working in auditing?

Specifically, this role allows me to be exposed to the development of the business strategy and roll-out of new initiatives by ensuring those programs can be sustainable and scalable. Auditing allows me to work closely with the business leaders to help understand its challenges and help shape the future of the organisation. For example, the success of the company is about driving the right behaviours to complement the systems and processes in play. The behavioural auditing programs that I have championed allow me to flush out the behaviours that are not aligned to the values of the business. In short, working the auditing space helps me play a critical role in making a business achieve its strategic goals.

What did you learn in your degree that has been most useful in your career?

The degree gave me a good understanding of the basic concepts. Examples are controls, systems and processes important in the ecosystem of an organisation.

What have you been up to since graduation?

On graduation I worked for the global accounting firm EY, both in Malaysia and Australia. I started off in the assurance function and then branched out into advisory (internal auditing and process improvement). During my tenure at EY, I worked across different industries, including Financial Services, Manufacturing, Mining, Public Sector and Services. I then set up the Internal Audit function of Asciano Limited. In 2016, Asciano was partly acquired by Brookfield Infrastructure Partners (NYSE-listed organisation/Global Alternative Asset Manager), and I was then offered the role to lead the Risk and Insurance function of the newly-established business (LINX Cargo Care Group).

What does your current job/position involve?

I am establishing the Enterprise Risk Management framework, the Anti-Bribery and Corruption Program, and the insurance strategy (including presenting to the insurance markets as part of the annual insurance renewal program). I am also working with the Legal and Operational functions to ensure contracts and initiatives have robust risk management practices.

What do you enjoy most about your work?

I worked closely with the senior leadership team to help make the business better (by rolling out new programs of work to drive optimal behaviours, improve competitiveness of the organisation, etc.) and keep them out of trouble (ensuring non-compliance is thoroughly investigated and addressed so it doesn't repeat itself and/or manifest into a bigger issue).

What advice would you give prospective students who want to pursue a career in auditing?

During the summer breaks, try and land an internship with one of the accounting firms, as the experience interns gain can put a lot of concepts they have studied at university into perspective.

What are your thoughts on the future of the auditing industry?

Auditing should be a strategic function of the organisation. This is because it plays a critical part in the ecosystem of an organisation. However, more work is required to educate business leaders on the true value of the auditing function and how a greater focus and investment in this function can generate dividends for the organisation.

CHAPTER 1

Assurance and auditing: an overview

LEARNING OBJECTIVES (LO)

- 1.1** Understand the framework for assurance engagements and the types of assurance engagements that can be provided.
- 1.2** Define auditing and appreciate the fundamental principles underlying an audit.
- 1.3** Appreciate the attributes of accounting information and understand the reasons giving rise to demand for assurance and resulting benefits.
- 1.4** Explain the concept of the expectation gap, especially in the areas of auditor's report messages, corporate failures, fraud and communicating different levels of assurance, and appreciate the relationships between the auditor, the client and the public.
- 1.5** Appreciate the role of auditing standards and their authority under the *Corporations Act 2001*.
- 1.6** Obtain an overview of other applications of the assurance function, including compliance engagements, performance engagements, comprehensive engagements, internal auditing and forensic auditing, as well as of providing assurance on subject matter other than historical financial information.

RELEVANT GUIDANCE	
ASA 102	<i>Compliance with Ethical Requirements when Performing Audits, Reviews and Other Assurance Engagements</i>
ASA 200/ISA 200	<i>Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Australian (International) Auditing Standards</i>
ASA 220/ISA 220	<i>Quality Control for an Audit of a Financial Report and Other Historical Financial Information</i>
ASAE 3000/ISAE 3000	<i>Assurance Engagements Other than Audits or Reviews of Historical Financial Information</i>
APES 210	<i>Conformity with Auditing and Assurance Standards</i>
AUASB	<i>Foreword to AUASB Pronouncements</i>
AUASB/IAASB	<i>AUASB Glossary/Glossary of Terms</i>
AUASB/IAASB	<i>Framework for Assurance Engagements/International Framework for Assurance Engagements</i>
IAASB	<i>Preface to the International Standards on Quality Control, Auditing, Review, Other Assurance and Related Services</i>

CHAPTER OUTLINE AND REVIEW OF CURRENT AUDITING ENVIRONMENT

Entities achieve their goals through the use of human and economic resources. In order to account for the use of these human and economic resources, entities issue reports explaining the use of the resources entrusted to their control.

These reports can take a number of forms, including financial reports, which are prepared in accordance with accounting standards in order to provide information on the financial position and performance of an entity, and environmental reports, which are prepared in accordance with environmental standards to provide information on the environmental performance of an entity. A primary function of the auditing and assurance profession is to provide independent and expert opinions on these reports based on an examination of the evidence underlying the information reported, in order to improve the credibility of these reports.

Auditors usually bring two major types of expertise to an audit. One of these is an expertise on the subject matter of the underlying report. For example, if the audit is of a financial report, this requires expertise on the accounting standards and regulations that underpin the financial report. Students will have started to develop this expertise by undertaking the financial accounting subjects contained in an accounting degree, and will further develop it in practice.

The second major type of expertise is auditing and assurance expertise. This involves, firstly, understanding the auditing and assurance services profession (Chapters 1–3). Further, for any particular engagement, it involves appropriately planning and assessing risk, including developing an understanding of the reporting entity and of the industry and environment in which it operates, assessing the major risks of misstatement in the underlying report (Chapters 4–7), collecting audit evidence so that the risk of misstatement is reduced to an acceptably low level (Chapters 8–10) and effectively communicating the findings (Chapters 11–12). This book explains this process and helps to develop this expertise.

The auditor has developed the audit process and their own expertise and reputation in the area of auditing financial reports. However, this process and expertise can be applied to areas other than financial reports, such as providing assurance on an entity's disclosure of its corporate social responsibility or its level of carbon emissions. The concept of applying the audit process more broadly is introduced in this chapter and discussed further in Chapters 13–15.

Figure 1.1 outlines the way the text works through the various stages of the audit process in a logical manner. Each step in the process builds on the steps that precede it. This framework is expanded upon in each chapter of the text.

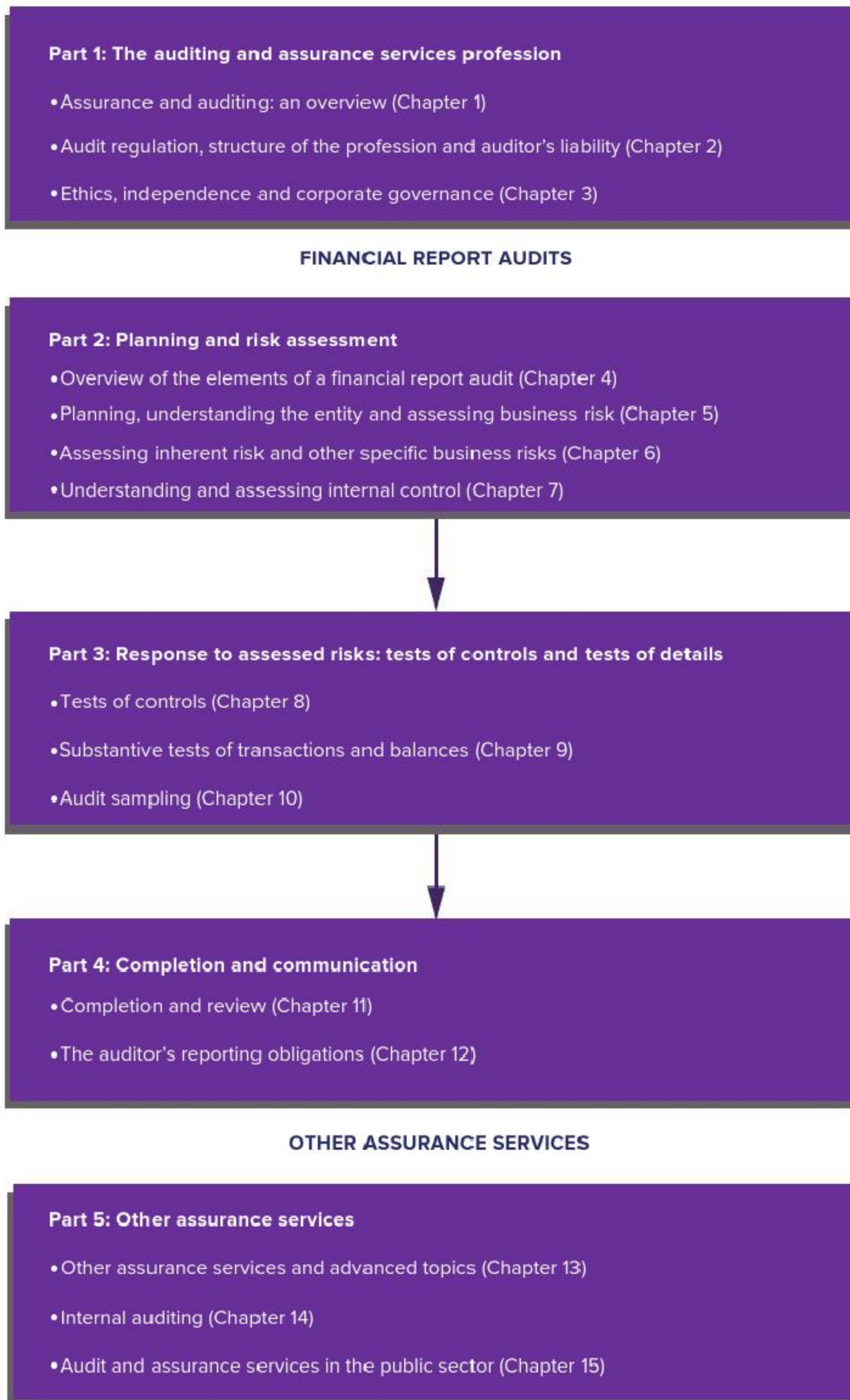


FIGURE 1.1 Flowchart of overall auditing and assurance framework