

Week 7: Substantive Testing I (TOD, audit evidence, audit sampling)

Substantive procedures are audit procedures designed to detect material misstatements at the assertion level. **Substantive procedures involve comparison between underlying accounting data to external evidence (corroborating information).** There are two types of substantive procedures:

1. **Substantive test of details** – substantive tests of account balances, transactions and disclosure to obtain audit evidence to detect material misstatements at the assertion level

Test of balances	Tests that substantiate account balances at period end – ACCERP
Test of transactions	To inspect underlying documents, to trace the flow of transactions through the accounting system and to recalculate for clerical accuracy. <ul style="list-style-type: none"> • VOUCH – from G/L to source documents (occurrence) • TRACE – from source documents to G/L (completeness)

2. **Substantive analytical procedures** – undertaking analytical procedures to determine the amount of misstatement in an account balance

Sufficient appropriate audit evidence

Auditors should select audit procedures to provide *sufficient* (quantity) *appropriate* (quality – relevant and reliable) audit evidence for the auditor to provide a reasonable basis for forming an audit opinion.

Test of details

Select samples → test samples → note error → based on errors, make an estimate of overall error

Types of substantive test of details:

Procedure	Explanation	Examples
Inspection	Examination of records, documents or tangible assets.	<ul style="list-style-type: none"> • Inspection of tangible assets provide audit evidence concerning their existence • External source documents (e.g. bank statements or title deed) to confirm rights and obligations/existence
Observation	Observation of the behaviour of operating personnel and the functioning of the business in operation	<ul style="list-style-type: none"> • Gathering evidence of control activities being carried out
External confirmation	A type of enquiry by which an auditor obtains direct written statements from a third party. Confirms existence .	<ul style="list-style-type: none"> • Trade debtors confirmation • Trade creditors confirmation • Bank confirmations • Solicitors representation letter
Re-calculation	Involves checking the mathematical accuracy of documents or records and may be performed manually or electronically.	<ul style="list-style-type: none"> • Reasonableness calculations (e.g. payroll tax) • Leave entitlements • Depreciation/amortisation expenses • Impairment calculation
Re-performance	The auditor may independently execute procedures or controls that were originally performed as part of the entity's internal control	
Enquiry	Interviewing and/or obtaining written statements from management and employees	<ul style="list-style-type: none"> • Enquiries of those charged with governance • Management • Accounts employees

TEST OF TRANSACTIONS

Example: Sales transactions

Assertion	Common substantive test procedures
Accuracy	Sales transaction (sales journal) → sales invoices → verify price to schedule of fees → verify quantity to shipping documentation
Cut-off	Take sample of sales transactions, from the sales journal, both during the current period and the next period, and compare the date in the journal to the date on the relevant document (such as a sales invoice or dispatch docket)
Completeness	Test from supporting document (invoice, delivery note) to sales journal
Classification	Take a sample of sales transactions and examine the sales invoice to check that it is an actual sale and not some other type of transaction, such as an asset disposal.
Occurrence	Vouch entries in sales journal to supporting documentation of sale (i.e. check if there is a sales invoice and goods dispatch note)
Presentation	<ul style="list-style-type: none"> • Is the P/L figure the same as that on the T/B? • Are the prior year figures correct? • Is the split between various revenue categories and between revenue and other income correct? • Is the note reference correct?

Example 2: Payroll expenses

Occurrence	Select transactions from payroll listing and agree to supporting documentation (e.g. time sheets)
Completeness	<ul style="list-style-type: none"> • Test from supporting documentation (e.g. time sheets) to payroll journal • Review for unmatched reports and staff records
Accuracy	Verify times, amounts and computation on timesheets to payroll and employment contract
Cut-off	Check that last payroll recorded before balance date, and first payroll records after balance date, are recorded in the correct period

Example 3: Depreciation expenses

*Note: before depreciation expense can be audited, the balance of PP&E (fixed assets) must be audited.

Accuracy	<ul style="list-style-type: none"> • Check the schedules to ensure that the right PP&E asset values were used in the calculations • Check that the depreciation rate and method conform to company policy and AASB 116 • Recalculate to check for mathematical error
Cut-off	Take a sample of PPE assets that were purchased during the year and check that they have only been depreciated for the period that were owned and not for the full year
Classification	Check the depreciation schedules to see if there are any charges that are not for depreciation of PPE assets
Completeness	Take a sample of depreciable assets from the fixed assets register and check that there is a charge for each one on the depreciation expense schedules
Occurrence	Take a sample of depreciation expense charges from the depreciation expense schedules and check that there is a depreciable asset in the fixed assets register for each one
Presentation	<p>Depreciation expense is not disclose separately but as part of:</p> <ul style="list-style-type: none"> • Other expenses in the P/L • PPE in the B/S <p>Read the depreciation information in the note and check details against G/L and depreciation schedules</p>