A69.

Exhibit A — Using ADAs to Simultaneously Accomplish Multiple Audit Procedures (Ref: par. A46 and par. A61)

This Exhibit illustrates use of an audit data analytic (ADA) that simultaneously accomplishes the objectives of both risk assessment and substantive audit procedures.

Background

The fact pattern in this example, where the auditor uses a revenue transaction scoring model, will focus on the audit of an entity that recognizes revenue when control of the product (or satisfaction of the performance obligation) transfers at a specific point in time,[1] such as a manufacturer of external data storage devices.

For purposes of this example, assume the following:

- Revenue was determined to be a material account during initial planning and scoping with the occurrence (including cut-off) and accuracy assertions being more susceptible to misstatement,
- The ADA was performed after initial planning and scoping as part of the ongoing and iterative risk assessment process,
- All transactions within the account were subject to the same processes and controls,
- The purpose of the ADA was to design the nature, timing, and extent of the audit procedures and to obtain audit evidence,
- Based on the understanding of controls, the auditor has concluded that the controls over revenue were effectively designed and have been implemented, the auditor has tested certain relevant controls and determined they are operating effectively, and the auditor is otherwise satisfied the entity has appropriately applied the requirements of the applicable financial reporting framework ((for example, FASB *Accounting Standards Codification* (ASC) 606, *Revenue from Contracts with Customers*),
- Data used in the ADA is relevant and reliable and has been tested for accuracy and completeness,
- Customers tend to purchase consistent quantities throughout the year, with the exception of purchases just prior to major retail holidays, such as Memorial Day, Black Friday, and Christmas,

[1] FASB *Accounting Standards Codification* 606-10-25-30.

- Some customers only purchase in bulk a few times a year, but most customers consistently purchase quantities one to two times a month,
- The customer base does not fluctuate significantly from period to period,
- Revenue is recognized when control transfers at FOB shipping point,
- Invoicing occurs the day the product ships from the entity's warehouse,
- Warehouse personnel typically do not work weekends, and
- The company does not sell product to any related parties.

All items that are determined to be individually material were excluded from the ADA and substantively tested separately. The remaining population that was subject to the ADA was comprised of routine, non-complex transactions with third parties. The processing and recording of transactions are highly automated and less likely to be susceptible to management override.

Description of the Audit Data Analytic

ADA Scoring Model - A complete population of transactions (at the individual item level) for one material account (excluding individually significant items) was subjected to an ADA designed to identify and assess risk and obtain audit evidence specific to a relevant assertion using different routines. The scoring of each routine is based on the evidence expected to be provided by that routine in relation to the auditor's assessment of the potential risk of material misstatement.

The routines were as follows:

Routine	Description	Characteristic	Transaction Scoring Model	Risk Score	Relevant Fact Pattern
1	Identify customers with infrequent revenue activity (less than X transactions)	Volume	Less than 6 transactions	2	Some customers only purchase in bulk a few times a year, but most customers consistently purchase quantities one to two times a month
			6- 12 transactions	1	Some customers only purchase in bulk a few times a year, whereas others purchase smaller quantities one to two times a month
			More than 12 transactions	0	
2	Identify customers with a significant fluctuation in volume of products purchased (item level) on a period over period basis	Volume	Greater than 70% variance	2	Customers tend to purchase consistent quantities throughout the year, with the exception of purchases just prior to major retail holidays, such as Memorial Day, Black Friday, and Christmas
			30-70% variance	1	Some customers only purchase in bulk a few times a year, but most customers consistently purchase quantities one to two times a month
			Less than 30% variance	0	
3	Identify activity for new customers	Volume	Customer for 6 months or less	1	The customer base does not fluctuate significantly from period to period
			Customer for greater than 6 months	0	
4	Identify all transactions recorded within X days of quarter-end.	Timing	Within 3 days of quarter end	1	Revenue is recognized when control transfers at FOB shipping point
			Greater than 3 days of quarter end	0	
5	Identify revenue transactions with an invoice date on	Timing	Transaction on a	2	Invoicing occurs the day the product ships from the company's warehouse

Routine	Description	Characteristic	Transaction Scoring Model	Risk Score	Relevant Fact Pattern
	an unusual date (e.g., weekend or holiday)		Weekend/Holiday		Warehouse personnel typically do not work weekends
			Transaction on a Weekday	0	
6	Identify instances where the shipping document and invoice don't match.	Timing	Invoice and shipping document don't match and invoice date is before shipping date	4	Revenue is recognized when control transfers at FOB shipping point
			Invoice and shipping document don't match and shipping date is before invoice date	2	Invoicing occurs the day the product ships from the company's warehouse
			Invoice and shipping document match	0	

Running the revenue transaction level detail through the ADA routines produces a total score for each transaction. The auditor then groups each transaction into a sub-population based on the individual transaction score. The number of sub-populations may differ depending upon the type of ADA developed, the scores produced by the ADA, and the auditor's assessment of those scores. For purposes of this example, the auditor grouped the population of the account into sub-populations as follows:

Assessed Risk	Total Risk Score	Group
High Risk	8 to 12	A
Moderate Risk	4 to 7	B
Low Risk	0 to 3	C

- Group A – High Risk - Comprised of items with characteristics deemed to present a higher risk of material misstatement.

  Approach - The auditor would perform additional substantive procedures to provide more persuasive audit evidence for the items identified by the ADA. For example, the nature of the substantive procedure may be confirmation as opposed to inspection; the extent of testing may be greater (larger proportionate sample size); or the timing of the procedure may be at or near the financial statement date as opposed to earlier in the period.

- Group B – Moderate Risk - Comprised of items that warrant further procedures but do not have characteristics of those in the higher risk group.

  Approach - The auditor would perform substantive procedures appropriate for the items identified by the ADA, in less depth relative to the higher risk population. For example, the nature of the substantive procedure may be limited to inspection of documents and records, the extent of testing may be less (smaller proportionate sample size), and the timing of the procedure may be earlier in the period.

- Group C – Low risk - Comprised of items that demonstrate no unusual characteristics based on the procedure performed using the ADA.

Approach - The results of other audit procedures performed throughout the audit would be evaluated for contradictory information regarding the assessed risk of material misstatement. In the absence of contradictory information, as the routines of the ADA are sufficiently precise for the auditor to conclude that the risks of material misstatement have been addressed, no additional substantive procedures may be warranted for any reason other than to incorporate an element of unpredictability in the selection of auditing procedures to be performed from year to year.

As a result of the procedures performed above, the auditor concluded:

Groups A, B, and C comprise a material account in the aggregate for which each Group has differing risks,

For Group C, the audit evidence provided over the transactions within the population analyzed by the ADA in combination with the audit evidence provided by testing of certain key controls over revenue as determined by the auditor and the absence of contradictory audit evidence from the testing of related accounts, was sufficiently persuasive for the auditor to conclude that the risk of material misstatement was addressed; and

For Groups A and B, the audit evidence provided by the ADA was not sufficiently persuasive and further substantive procedures were required to address the risk of material misstatement.