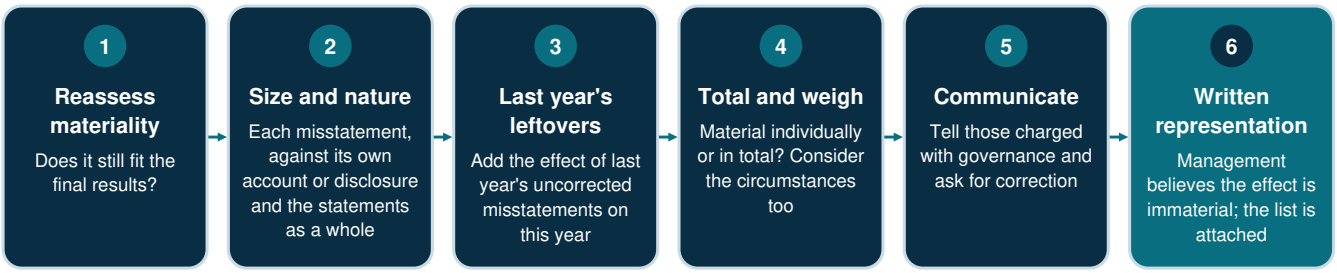
Final evaluation of misstatements

MODULE 4 | 4.2.1 | STUDENT COMPANION

Before forming an opinion, the auditor **reassesses materiality** against the final results, then evaluates the **uncorrected misstatements** individually and in total, including the effect of those left over from **prior periods** (ASA 450). Size isn't everything: the **nature and circumstances** of a misstatement can make a small one material. A **technical review** checks the statements against the framework and the law. When misstatements are material, **pervasiveness** decides between a qualified and an adverse opinion.

Evaluating uncorrected misstatements



Voltana, step 1: final profit before tax is about $9.5m, after the Module 3 corrections and the extra allowance for the customer in liquidation. 5% x $9.5m = about $475,000, close enough to the revised materiality of about $480,000 that no further change is needed.

Why reassess materiality? It was set at planning from expected figures and revised after the Module 3 corrections. If the final results differ a lot, a lower figure may be needed, and with it more work, before the misstatements are judged.

Voltana's final schedule of uncorrected misstatements

Uncorrected misstatement	Arose	Profit overstated by
Projected misstatement in partner electrician receivables	This year (sample projection)	**about $18,000**
Understated accrual	This year	**about $22,000**
Staff bonus over-accrual left uncorrected last year, released into this year's profit	**Last year (accepted then as immaterial)**	**about $150,000**
Total uncorrected misstatements		**about $190,000**



Interest cover covenant
Not affected in any meaningful way

Trends
No trend changed

Fraud concerns
Not related: corrected and dealt with separately

How last year's leftover reaches this year's profit. Last year's staff bonus accrual was about $150,000 too high, so last year's expenses were overstated and its profit understated. Management left it, and the auditor

accepted it as immaterial. This year the excess was released, so this year's expenses are understated and profit overstated by the same $150,000. ASA 450 accepts more than one way to evaluate prior-period misstatements, for example by their effect on this year's profit or on the closing balances, as long as the approach is applied consistently from year to year.

When a small misstatement can still be material

Circumstance	Why users would care
Affects compliance with a loan covenant or regulatory requirement	A small change could put the entity in breach, with large consequences
Turns a loss into a profit, or masks a change in trend	Users judge direction as much as size
Affects information about operating segments	A segment may be important even when the amount is small for the entity
Increases management's pay	For example, it is what makes a bonus target
Involves a related party or an illegal act	The nature matters more than the amount
Results from fraud	It says something about integrity and other evidence (ASA 240)

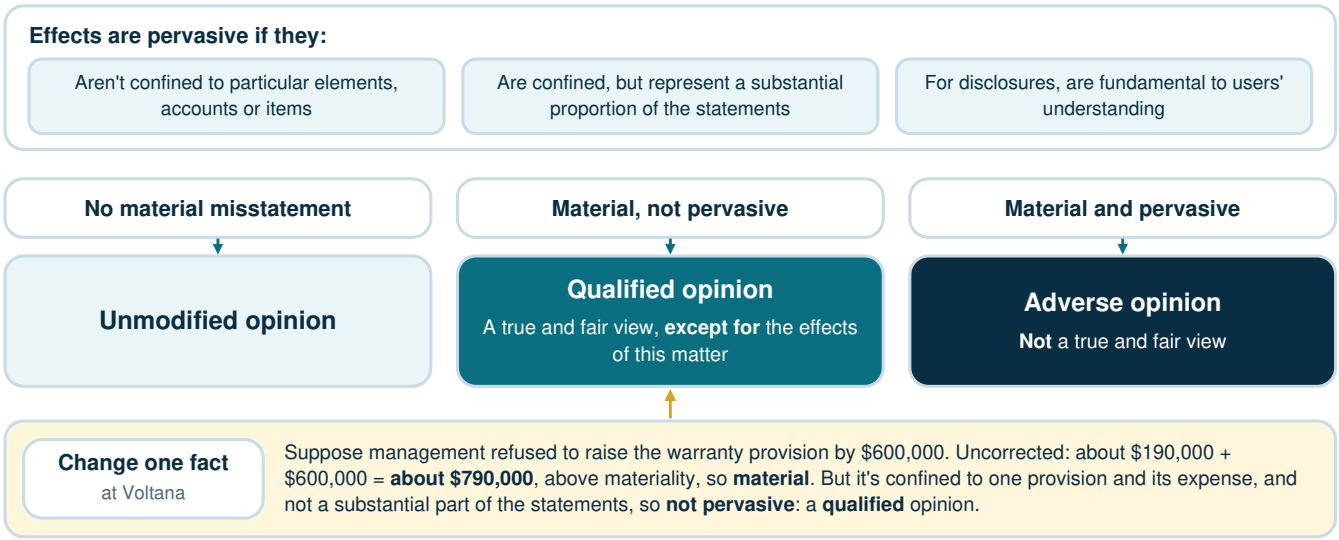
Voltana's check. The uncorrected items don't affect the interest cover covenant in any meaningful way, don't change any trend, and aren't related to the fraud concerns, which were corrected and are being dealt with separately. So they aren't material, individually or in total. The team still communicates them to the audit committee, asks for them to be corrected, and obtains management's written representation that their effect is immaterial, with the full list included in the letter.

The technical review

Using a disclosure checklist, an experienced reviewer confirms that:

- the statements comply with the accounting standards and the Corporations Act;
- the notes are complete and consistent with the primary statements;
- the directors' declaration and the other required statements are present;
- the disclosures the audit focused on are right: at Voltana, the related party notes, the class action contingent liability, the recycling acquisition agreed after year end, and the uncertainty in the warranty provision.

Pervasiveness and the opinion



Australian wording. A qualified opinion: true and fair, **except for** the effects of this matter. An adverse opinion: **not** true and fair. The Exam Reference Pack (page 8) sets out the full grid, including what happens when the auditor can't obtain enough evidence.

Practice questions

MODULE 4 | 4.2.1 | TRY THESE BEFORE THE WORKED ANSWERS

Question 1 - Blackbutt's uncorrected misstatements

Blackbutt Timber Floors Ltd (imagined) reports profit before tax of $3.2m (last year $3.15m). Materiality is $160,000. Executives share a bonus pool only if profit before tax beats last year's. Management won't correct the items below. Evaluate them by size and by nature.

	Uncorrected misstatement	Kind	Effect on profit
1	Pricing errors found in an inventory sample, projected to the whole population	Projected	Overstated $36,000
2	Refunds owed for a faulty June batch of flooring, not provided for	Factual	Overstated $24,000
3	Long service leave: management's provision $310,000; the auditor's estimate $340,000	Judgemental	Overstated $30,000
4	A supplier's volume rebate earned in the year but not recorded	Factual	Understated $18,000
5	A $12,000 payment to a council planning officer to speed up a permit, recorded as consulting fees	Factual	No effect on total profit

Question 2 - Last year's leftovers

Blackbutt left each of these uncorrected last year as immaterial. Explain how each affects the profit for the year to 30 June 2026.

Uncorrected at the end of last year (year to 30 June 2025)	Effect on this year's profit, and why
(a) Last year's closing inventory was overstated by $50,000. This year's closing inventory is correct.	
(b) Last year, $40,000 of revenue for jobs done in July 2025 was recorded in June 2025.	
(c) On 1 July 2024, $60,000 of repairs was capitalised as equipment and depreciated over ten years.	

Question 3 - Pervasive or not?

Marrakai Packaging Group Ltd (imagined) has revenue of $90m, total assets of $60m, profit before tax of $8m and materiality of $400,000. Consider each misstatement on its own: is it pervasive, and which opinion would it lead to if left uncorrected?

Material misstatement	Pervasive?	Opinion
(a) Obsolete stock at one of five warehouses hasn't been written down: inventory and profit are overstated by $1.2m.		
(b) Revenue from multi-year supply contracts is recognised in full when each contract is signed. Correcting it would cut revenue by about a third, turn the profit into a large loss, and change receivables, contract liabilities, tax and equity.		
(c) $2.1m of development costs has been capitalised although the project doesn't meet the recognition criteria.		
(d) In August the directors decided to stop trading and sell the business in parts, but the statements are still prepared on the going concern basis.		

Worked answers

MODULE 4 | 4.2.1 | WORKED ANSWERS - ATTEMPT THE QUESTIONS FIRST

Question 1 - Blackbutt Timber Floors (sample answer)

- **By size:** the net overstatement is $36,000 + $24,000 + $30,000 - $18,000 = $72,000 (gross $90,000), and no single item comes near $160,000. On size alone, the misstatements aren't material.
- **Trend:** corrected profit would be $3.2m - $0.072m = $3.128m, below last year's $3.15m. The misstatements turn a small fall into a reported rise, so they mask a change in trend.
- **Management's pay:** the executive bonus pool is triggered only because of the misstatements, so they increase management's pay.
- **The $12,000 payment:** it may be a bribe to a public official, an illegal act. Its nature makes it material whatever its size: understand what happened, raise it with those charged with governance, consider legal advice and any duty to report (ASA 250), and reconsider management's integrity.
- **Pattern:** every judgement except the rebate favours profit, a possible sign of bias.
- **Conclusion:** material by nature. Ask management to correct them; if it won't, a qualified opinion (material, but confined to particular items, so not pervasive).

Question 2 - Last year's leftovers (suggested)

	Effect on this year's profit	Why
(a)	Understated by $50,000	This year's opening inventory is overstated, so cost of sales is overstated; the error reverses
(b)	Understated by $40,000	The July jobs belong to this year, but their revenue was already recorded last year, while their costs fall this year
(c)	Understated by $6,000	This year's depreciation on an asset that shouldn't exist. The error doesn't reverse: equipment is still overstated by $48,000 at 30 June 2026. Judged on this year's profit it's $6,000; judged on the closing balances it's $48,000

Question 3 - Pervasive or not? (suggested)

	Pervasive?	Opinion
(a)	No: confined to inventory and cost of sales, and not a substantial part	Qualified: true and fair except for
(b)	Yes: not confined, and it turns the profit into a loss across most of the statements	Adverse: not true and fair
(c)	No: confined to intangibles and expenses; material, but not a substantial part	Qualified: true and fair except for
(d)	Yes: the wrong basis affects how almost everything is measured and classified	Adverse: not true and fair