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AUD

Copernicus CPA Review

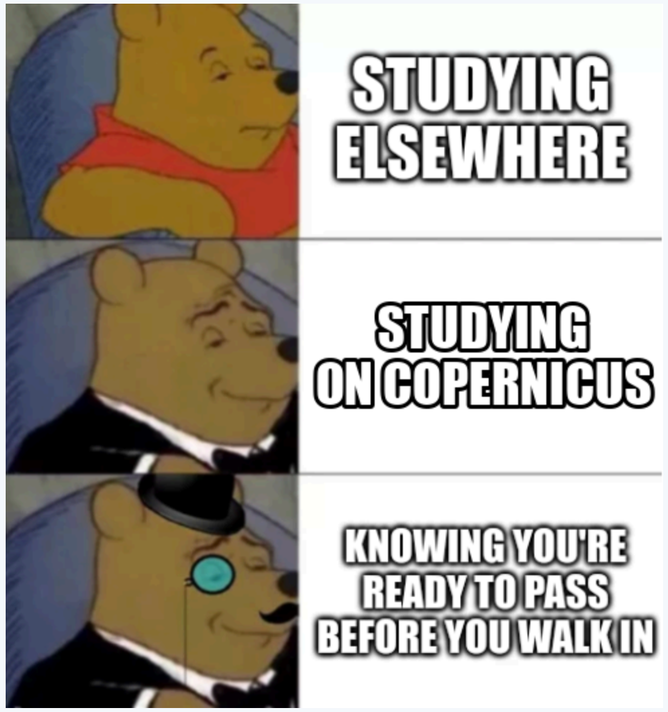
Hey there! This is the version of our memorization guide for CPA candidates who aren't yet actively studying on our platform. It has everything the other version does, and includes two extra slides including this one to let you know why you might want to give Copernicus CPA Review a try.

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AUD Exam Memorization Guide

Guide version 5.3.1

This guide reflects the current AICPA Exam Blueprint for AUD, including coverage of the AICPA's Clarified Auditing Standards (AU-C), PCAOB Auditing Standards (AS), Government Auditing Standards (Yellow Book), and the AICPA's Statements on Standards for Attestation Engagements (SSAEs). Content incorporates the Quality Management Standards (SQMS No. 1 and SQMS No. 2), which replaced the legacy quality control standards, and current PCAOB standards, including AS 1000 (General Responsibilities of the Auditor in Conducting an Audit). All ethical standards reflect the AICPA Code of Professional Conduct as currently effective. Every page is checked line by line against primary authority before each version is released.

Memorization Guide

Each of the CPA exams is different. The AUD exam has commonly been discussed as the exam seemingly having “three right answers” for each question. While this is a pain, the answer choices DO have differences, albeit slight ones. What will help you choose the correct answer for each question on the exam? Memorizing everything in this guide. These minuscule differences can be distinguished by memorizing the various engagement types, their slightly varying attributes, and the format of each engagement type.

When it comes to the formulas, ratios, and content included here, my sincere advice is to not enter the exam until it is all memorized. Do not view this as a cause for concern; rather, view it as a lifesaving guide that will earn you free and stress-free points on the exam. Do the heavy lifting now while you have time, rather than a week before the exam when you would have to cram.

Types of engagements and their attributes

Standard	SAS	SAS	PCAOB AS	PCAOB AS
Service Type	**Audits**	**Reviews**	**Audits**	**Reviews**
Audited / Unaudited FS	Audited	Unaudited (interim)	Audited	Unaudited (interim)
Issuer / Non-issuer	Non-issuer	Non-issuer	Issuers	Issuers
Assurance Type	Reasonable Assurance	Limited Assurance	Reasonable Assurance	Limited Assurance
Report	Opinion	Conclusion	Opinion	Conclusion
Independence	Independent	Independent	Independent	Independent
Restricted Use	No	No	No	No
Special Requirement	Client representation letter needed.	Inquiries of internal personnel and analytical procedures. Client representation letter needed.	Client representation letter needed.	Inquiries of internal personnel and analytical procedures. Client representation letter needed.

Types of engagements and their attributes (continued)

Standard	GAGAS	GAGAS	SSAE
Service Type	**Financial audit**	**Performance audit**	**Examination (assertion-based or direct)**
Audited / Unaudited FS	Audited	N/A (no FS opinion)	N/A
Issuer / Non-issuer	Governments and recipients of government awards	Governments and recipients of government awards	Both
Assurance Type	Reasonable Assurance	Reasonable Assurance (performance audit: reasonable basis)	Reasonable Assurance
Report	Opinion	Findings and conclusions	Opinion
Independence	Independent	Independent	Independent
Restricted Use	No	No	Alert restricting use when criteria are suitable only for, or available only to, specified parties
Special Requirement	Client representation letter needed. Also report on internal control over financial reporting and on compliance.	No	Direct examination (SSAE 21): the practitioner measures the subject matter against criteria; no responsible-party assertion needed.

Types of engagements and their attributes (continued)

Standard	SSAE	SSAE	SSAE
Service Type	**Examination of management assertion**	**Review**	**Agreed-upon procedures**
Audited / Unaudited FS	N/A	N/A	N/A
Issuer / Non-issuer	Both	Both	Both
Assurance Type	Reasonable Assurance	Limited Assurance	No Assurance
Report	Opinion on the subject matter or on whether the assertion is fairly stated, in all material respects	Conclusion	Findings
Independence	Independent	Independent	Independent
Restricted Use	Alert restricting use when criteria are suitable only for, or available only to, specified parties	Alert restricting use when criteria are suitable only for, or available only to, specified parties	General use allowed; restriction optional
Special Requirement	Written representations from the responsible party needed.	Inquiries of internal personnel and analytical procedures. Client representation letter needed. Not allowed for prospective financial information, internal control, or compliance.	No

Types of engagements and their attributes (continued)

Standard	SSAE	SSAE	SSAE	SSAE
Service Type	**Assurance on investment performance statistics**	**MD&A**	**Compliance**	**Review of Pro-forma financial statements**
Audited / Unaudited FS	N/A	N/A	N/A	N/A
Issuer / Non-issuer	Both	Both	Both	Both
Assurance Type	Assurance of the engagement type performed (examination: reasonable; review: limited; agreed-upon procedures: none)	Examination: reasonable assurance; review: limited assurance	Examination: reasonable assurance; agreed-upon procedures: no assurance	Limited Assurance
Report	Examination: opinion; review: conclusion; agreed-upon procedures: findings	Examination: opinion; review: conclusion	Examination: opinion; agreed-upon procedures: findings, without an opinion or conclusion	Conclusion
Independence	Independent	Independent	Independent	Independent
Restricted Use	Per engagement type performed	Alert restricting use when criteria are suitable only for, or available only to, specified parties	Per engagement type performed	Alert restricting use when criteria are suitable only for, or available only to, specified parties
Special Requirement	No	Practitioner must have audited the latest annual FS (interim review: also reviewed or audited the interim FS).	A review of compliance is prohibited.	Historical FS must have been audited or reviewed; include summary of significant assumptions.

Types of engagements and their attributes (continued)

Standard	SSAE	SSARS	SSARS
Service Type	**Prospective financial information (forecast or projection): examination or agreed-upon procedures only; no review**	**Preparation**	**Compilation**
Audited / Unaudited FS	N/A	Unaudited	Unaudited
Issuer / Non-issuer	Both	Non-issuers	Non-issuers
Assurance Type	Examination: reasonable assurance; agreed-upon procedures: no assurance	No Assurance	No Assurance
Report	Examination: opinion; agreed-upon procedures: findings	No report (no assurance)	Compilation report (no assurance)
Independence	Independent	Not required	Not required (disclose if impaired)
Restricted Use	Forecast: no; projection: yes	No	No
Special Requirement	Summary of significant assumptions required (projection: also the hypothetical assumptions).	Each page must state that no assurance is provided.	Compilation: disclose impaired independence. Engagement letter needed for both.

Types of engagements and their attributes (continued)

Standard	SSARS	SSARS	SSARS	SSARS
Service Type	**Reviews**	**Pro-forma Financial statements**	**Financial Forecasts**	**Financial Projection**
Audited / Unaudited FS	Unaudited	Unaudited	Unaudited	Unaudited
Issuer / Non-issuer	Non-issuers	Non-issuers	Non-issuers	Non-issuers
Assurance Type	Limited Assurance	No Assurance	No Assurance	No Assurance
Report	Conclusion	Compilation report (no assurance)	Compilation report (no assurance)	Compilation report (no assurance)
Independence	Required	Not required (disclose if impaired)	Not required (disclose if impaired)	Not required (disclose if impaired)
Restricted Use	No	No	No	Yes
Special Requirement	Inquiries of internal personnel and analytical procedures. Client representation letter needed.	Historical FS must have been compiled, reviewed, or audited; include summary of significant assumptions.	Summary of significant assumptions required.	Summary of significant assumptions, hypothetical assumptions, and limits on usefulness required.

- Preparation: engagement letter required; no report, but each page states that no assurance is provided. Compilation: engagement letter and compilation report. Review: independence, engagement letter, management representation letter and review report.

The audit process - all stages

General Principles

Overall objectives
Documentation
Communication
Quality management - firm (SQMS No. 1)

Engagement Acceptance

Ethics and independence
Terms of engagement

Assess Risk and Plan Response

Audit planning, including audit strategy
Materiality
Risk assessment procedures:
- Understand the entity and its environment
- Understand internal control

Identify and assess risk
Respond to risk

Perform Procedures and Obtain Evidence

Test of controls, if applicable
Substantive testing

Form Conclusions

Subsequent events
Management representation
Evaluate audit results
Quality management - engagement (SAS No. 146, AU-C 220); SQMS No. 2 for engagement quality reviews, when required

Reporting

Report on audited financial statements
Other reporting considerations

Quality management standards

- SQMS No. 1 has eight components: governance and leadership; risk assessment process; relevant ethical requirements; acceptance and continuance; engagement performance; resources; information and communication; monitoring and remediation.
- Issuer audit firms: PCAOB QC 1000 (effective Dec 15, 2026; risk-based quality control system: objectives, quality risks, responses).

The audit process - all stages (continued)

Audit Stage	Actions to Take	Items to Document
Engagement Acceptance		
Ethics and Independence		Independence and ethics conclusions, including threats identified and safeguards applied
Terms of Engagement	Communicate with predecessor auditor Engagement letter	Agreed terms in an engagement letter or other suitable written agreement (AU-C 210); communications with the predecessor auditor, when applicable

The audit process - all stages (continued)

Audit Stage	Actions to Take		Items to Document
Planning an Engagement			
Understanding Client	Industry Knowledge	Consider before acceptance (competence to perform); deepen during planning and risk assessment.	
	Business Knowledge	Tour facility Review financial history Inquiry	Relevant industry, regulatory and other external factors Nature of entity
Audit Strategy	Preliminary assessment of materiality Outline scope, reporting objectives, timing, required communications, and factors that determine focus	Staff the audit Consider work of internal auditor Use of specialist Materiality calculation	
Audit Plan	Written plan outlining the nature, extent, and timing of audit procedures	Risk Assessment Tests of Controls Substantive Procedures Other audit procedures	Understanding of entity control activities Assessment of risk of material misstatement at financial statement and assertion level

The audit process - all stages (continued)

Audit Stage	Actions to Take		Items to Document
Execute Audit			
Perform Procedures & Obtain Evidence	Test of Controls	Test operating effectiveness when relying on controls, or when substantive procedures alone cannot give sufficient evidence (AU-C 330.08). Design and implementation are evaluated during risk assessment (AU-C 315).	Controls tested, results, and conclusion on operating effectiveness (AU-C 330)
	Substantive Testing	Interim Testing (account balances reasonably predictable) or Year End Interim testing: cover the remaining period to year-end with further substantive procedures, or substantive procedures plus tests of controls (AU-C 330).	Items tested, procedures performed, results and conclusions (AU-C 230)

The audit process - all stages (continued)

Audit Stage	Actions to Take		Items to Document
Form Conclusions	Subsequent Events		Subsequent events procedures and results through the report date (AU-C 560)
	Obtain management written representations		Signed representation letter dated as of the auditor's report date (AU-C 580)
	Evaluate Audit results		Clearly trivial threshold; misstatements accumulated and whether corrected; materiality conclusion on uncorrected misstatements (AU-C 450)
	Quality management (engagement partner review; engagement quality review when required)		Evidence of engagement partner review and of any required engagement quality review
Reporting	Communicate with those charged with governance throughout the audit: planned scope and timing early, significant findings timely (AU-C 260).	Form the opinion and issue the auditor's report.	Communications with those charged with governance; report release date; final file assembled within 60 days after release (AU-C 230)

Audit committee & its responsibility

Management is responsible for the fair presentation of the financial statements; the audit committee oversees the reporting process and the external auditor, and reviews the results of the audit.

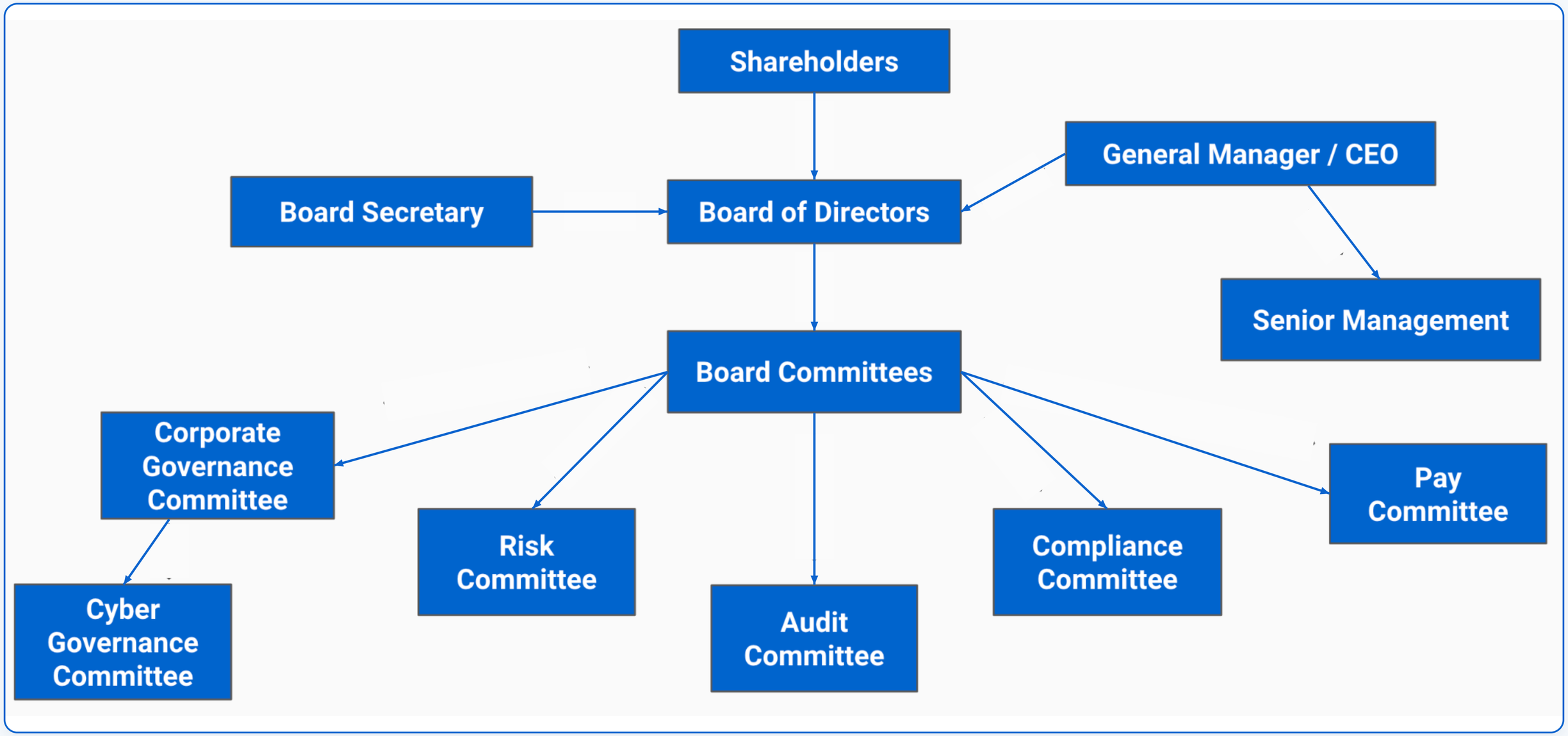
The audit committee is responsible for:

- Selecting and appointing the independent auditor (issuers; others per governance).
- Resolving disagreements between the auditor and management.
- Reviewing the scope of the audit.
- Issuers: the audit committee also sets the auditor's compensation, oversees retention, and preapproves audit and permitted non-audit services.

Who selects and appoints the independent external auditor?

- Issuers: the audit committee (Sarbanes-Oxley Act Section 301; Securities and Exchange Commission Rule 10A-3). Nonissuers: depends on governance (board, owners or management).

Audit committee & its responsibility (continued)



Change in scope or engagement type

In auditing, the scope of an engagement may be changed or the type of engagement may be changed. This could be due to a change in circumstances affecting the need for the service, or a misunderstanding about the service originally requested. A change in scope changes the nature, timing or extent of audit procedures. A change in engagement type changes the service (for example, audit to review) and its level of assurance, and needs reasonable justification (AU-C 210.17-.18).

A concern regarding all of this is the consideration of whether or not the reason for the change is a legitimate and acceptable reason.

The following are acceptable reasons for the change in scope of an engagement or engagement type:

- The client was originally requesting the engagement for a bank loan and now the bank changed the level of assurance needed from positive to negative assurance.

Change in scope or engagement type (continued)

The following are unacceptable reasons to change from an audit to a lower level of service:

- Audit procedures may discover fraud or material misstatement.
- Management does not want the auditor corresponding with third parties.
- Management refuses to sign a representation letter.

Justified change: document the new terms in a new engagement letter. Unjustified change and management won't let the audit continue: withdraw (if legally possible), tell those charged with governance, and consider any duty to report to others (AU-C 210.19-.20).

Types of audit opinions & reasons for each

Situation	Opinion	Misstatements/Issues	Attributes
Audit Issues	Disclaimer	Material and pervasive scope limitation	Scope limitation.
	Qualified	Material scope limitation, but not pervasive	Material scope limitation (unable to obtain sufficient appropriate audit evidence).
Financial Statements Materially Correct	Unmodified (Unqualified)	None or immaterial (Clean)	Clean opinion, financial statements are free from material misstatements.
Financial Statement Issues	Qualified	Material misstatement / GAAP departure, but not pervasive	Material departure from GAAP, but not pervasive.
	Adverse	Material and pervasive departure from GAAP	Pervasive, significant material misstatements, departure from GAAP.

Issuers receive unqualified opinions while nonissuers receive unmodified opinions.

Pervasive means widespread or throughout the financial statements as a whole.

“In the context of misstatements or an inability to obtain sufficient appropriate audit evidence, the term pervasive is used to describe the effects or possible effects on the financial statements of a matter that, in the auditor’s judgment, are not confined to specific elements, accounts or items of the financial statements, or, if confined, represent or could represent a substantial proportion of the financial statements, or, with regard to disclosures, are fundamental to users' understanding of the financial statements.”

Positive vs negative assurance

Negative (limited) assurance is expressed as a conclusion that nothing came to the accountant's attention indicating material misstatement, rather than a positive opinion. Positive assurance is a type of assurance in which the auditor expresses an opinion on the financial statements.

Negative assurance is a statement by an auditor that, after performing certain procedures, nothing came to their attention to indicate that a subject matter (like financial statements) is not in conformity with a specific standard. It is a form of limited assurance that provides a lower level of comfort than a positive opinion, because it confirms what is not found, rather than providing a positive statement that something is correct. It does not mean there are no issues; it means the practitioner is not aware of any material modifications that should be made.

Positive (reasonable) assurance is a high, but not absolute, level of assurance that the financial statements are free of material misstatement, expressed as an opinion.

Positive vs negative assurance (continued)

The conclusion in a limited assurance engagement is accordingly framed in a negative sense:

"Based on our review, we are not aware of any material modifications that should be made to management of XYZ Company's assertion in order for it to be fairly stated."

By contrast, a reasonable assurance (examination) opinion is expressed in a positive sense, for example: "In our opinion, management's assertion about XYZ is fairly stated, in all material respects."

Audit terms

Should - Presumptively mandatory requirement which should be followed in all cases with the exception of a few rare circumstances. A rare departure requires alternative procedures that achieve the requirement's intent, with the justification documented (AU-C 200; AU-C 230).

May / Might / Could - AICPA (AU-C): explanatory material; no requirement. Public Company Accounting Oversight Board (PCAOB): actions the auditor has a responsibility to consider.

Must - Unconditional requirement: must be followed in all cases where the requirement applies.

Reasonable assurance - Not absolute, however still a high level of assurance about whether the subject matter is free of material misstatement.

Alternative auditing procedures

Omission of Confirmation Procedures for Investments: If an auditor has omitted the confirmation of investments but has performed alternative procedures that yield sufficient evidence, the omission does not impair the auditor's ability to support a previously expressed unmodified opinion. In other words, alternative procedures can sometimes compensate for standard procedures that were not completed, as long as they provide adequate support for the auditor's conclusions.

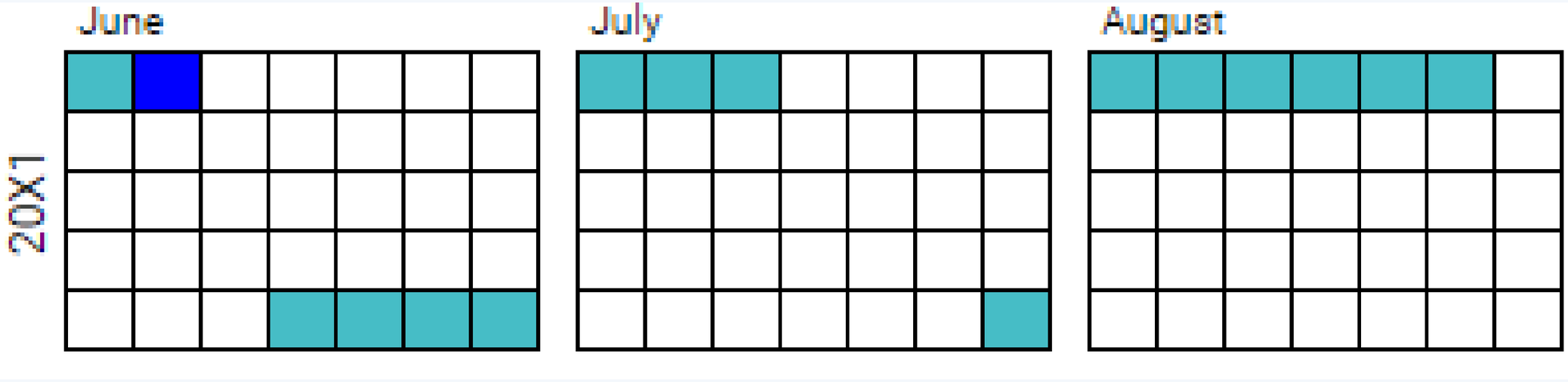
Inconsistency in Accounting Policies: If an auditor identifies inconsistencies in the accounting policies between the opening balances and the period under audit, the auditor should obtain evidence to ensure that any changes in policies have been appropriately accounted for, presented, and disclosed in accordance with the applicable financial reporting framework. The focus is not just on identifying the inconsistency but also on assessing its impact and appropriateness.

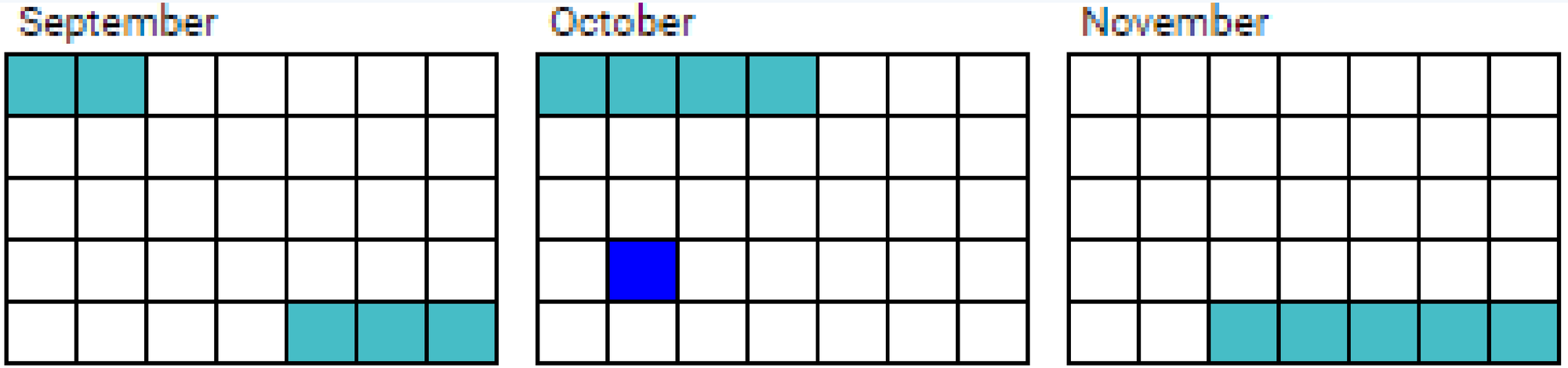
Alternative auditing procedures (continued)

After report release, first assess whether an omitted necessary procedure affects the ability to support the opinion. If it does and users are relying or likely to rely on the report, promptly perform the omitted or alternative procedures and document them. Apply the subsequently discovered facts requirements if the new evidence could require revision of the report.

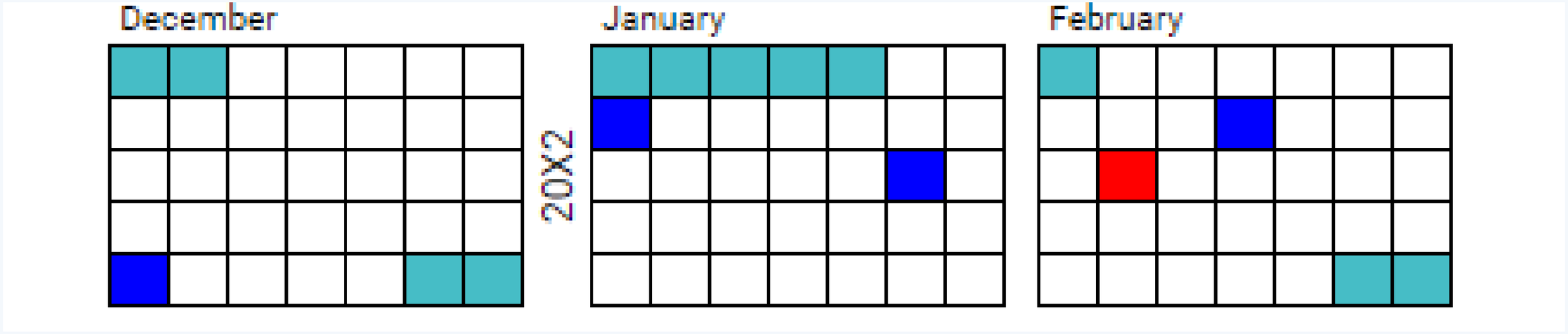
Public Company Accounting Oversight Board (PCAOB), issuers: amended AS 2901 (effective December 15, 2026) covers any engagement deficiency found after the report is issued (financial statement audit or audit of internal control over financial reporting); respond unless it is probable the report is not being relied on.

Audit opinion process

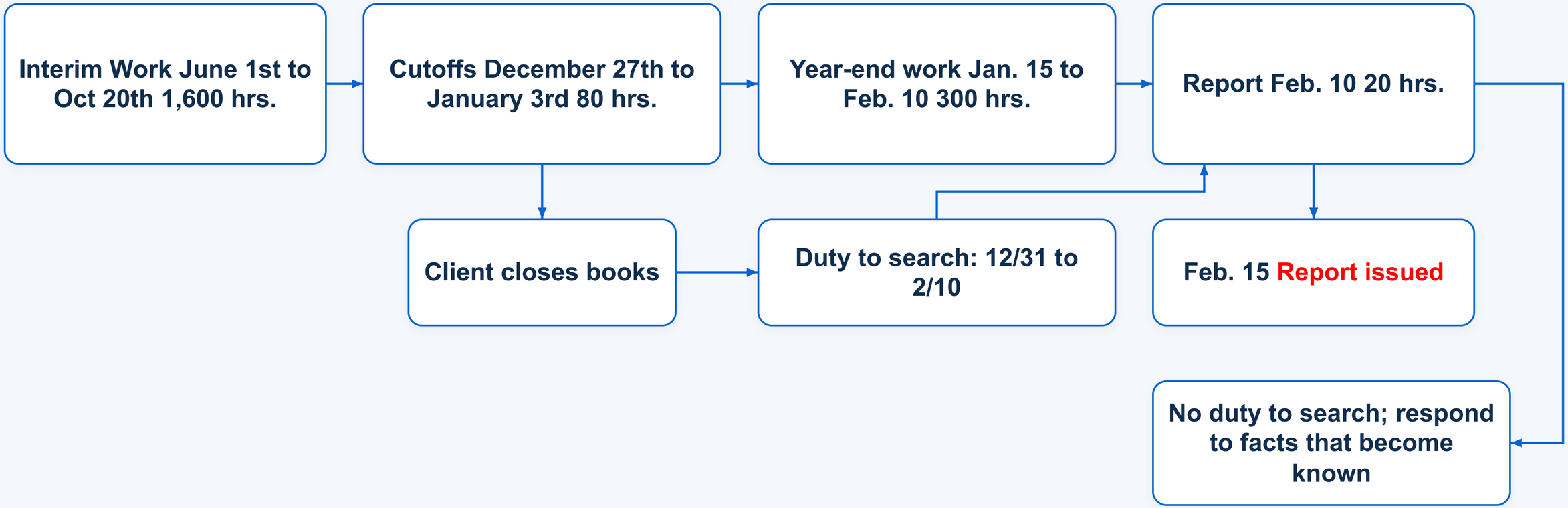




Audit opinion process (continued)



Audit opinion process (continued)



Audit opinion process (continued)

Interim Work	Cutoffs	Year-end work	Report
• Confirms of: cash, AR, NR, etc. • Cash reconciliations • Special account analysis • Physical inventory observation • Fixed asset verification • Tests of sales and payroll • Internal control review	Year-end inventory observation and cutoff tests of cash, AR, inventory, AP, sales, etc. Roll interim confirmations and early inventory counts forward to year-end.	• Review of subsequent AR collections • Follow up on confirm requests • Search for unrecorded liabilities • Subsequent events audit program: “PRIME”	Obtain management representation letter dated as of the auditor's report date (Feb. 10)

Examples of auditor independence impairments

The following items would impair independence:

- Accepting a gift from an audit client that is not clearly insignificant to the recipient, or offering a gift or entertainment that is not reasonable in the circumstances.
- Credit cards and overdraft reserve accounts from a bank audit client with an aggregate balance of more than $10,000 on a current basis.
- An auditor's uninsured deposits at a bank audit client are material to the auditor and the bank's risk of financial difficulty is not remote.
- When a close relative of an engagement team member works for an audit client during the period under audit in a key position.
- A covered member has a direct financial interest in the audit client (material or not), or a material indirect financial interest.
- The audit firm has an outstanding lawsuit against the audit client for a material dollar amount for work related to the audit.
- Expressed intention by the present management to commence litigation against the audit firm alleging deficiencies in audit work for the client if the claim is probable to be filed.

Examples of auditor independence impairments (continued)

The following items would not impair independence:

- Accepting a gift from an audit client that is clearly insignificant to the recipient, or offering a gift or entertainment that is reasonable in the circumstances.
- Credit cards and overdraft reserve accounts from a bank audit client with an aggregate balance of $10,000 or less on a current basis.
- An auditor's deposits at a bank audit client are fully insured, or any uninsured amount is immaterial to the auditor's net worth.
- When an auditor’s close relative works for an audit client during the period under audit in a non-key position.
- When an auditor receives an unsolicited financial interest in an audit client through a situation such as an inheritance and disposes of the financial interest as soon as practicable but no later than 30 days after the auditor knows of it and can dispose of it; while unable to dispose of it, the auditor does not participate on the attest engagement team, and the interest is not material to the auditor.
- A member of the audit team serves on an advisory board for the audit client that is purely advisory, does not make or appear to make management decisions, and is distinct from those charged with governance, with minimal common membership.
- The audit firm has an outstanding lawsuit against the audit client for an immaterial dollar amount for work unrelated to the audit.

Independence impairments

Summary of Independence Standards

	AICPA	SOX/PCAOB/SEC	DOL (employee benefit plan audits)
	Standards for assurance engagements (issuers and nonissuers)	Standards for audits/reviews of issuers	Standards for audits of employee benefit plans
The following items impair independence:			
Direct financial interest	X	X	X
Material indirect financial interest	X	X	X
Nonfinancial institution loan to or from client	X	X	
Former partner or professional employee joins the client in a key position: impairs unless all safeguards are met (amounts owed immaterial with a fixed formula, no influence over the firm, no participation in firm business, team safeguards)	X	X	

Independence impairments (continued)

	AICPA	SOX/PCAOB/SEC	DOL (employee benefit plan audits)
Former issuer audit engagement team member takes a financial reporting oversight role (CEO, CFO, controller, etc.) within the SEC one-year cooling-off period	Permitted with appropriate safeguards	X	
Employment at client of immediate/close family member in a key position	X	X	
Individual who participates in the engagement is seeking or discussing potential employment with the client or has been offered employment by the client, unless the individual notifies the firm and is removed from the engagement	X	X	
Former employee of the client participates on the engagement team when the engagement covers any period of the individual's employment with the client	X	X	X

Loans from a bank audit client: grandfathered loans (e.g., a home mortgage obtained before the client relationship, under normal terms) are allowed; new loans are permitted only for auto loans or leases secured by the auto, loans fully secured by insurance cash value or by deposits at the same bank, and credit cards and overdraft accounts with an aggregate balance of $10,000 or less on a current basis (ET 1.260.020).

Independence standards - disallowed services

Summary of Independence Standards

	AICPA	SOX/PCAOB/SEC	DOL
	Standards for assurance engagements (issuers and nonissuers)	Standards for audits/reviews of issuers	Standards for audits of employee benefit plans
Non-attest services:			
Bookkeeping	C (authorizing transactions or controlling client funds: X)	X	X
Financial information systems design or development	X	X	
Financial information systems implementation (e.g., installing off-the-shelf software, configuring client-selected vendor options)	C	X	
Appraisal and valuation services	X if significant subjectivity and material; otherwise C	X	

X = prohibited; C = permitted only if the general nonattest requirements are met (client assumes all management responsibilities, designated individual with suitable skill, documented scope).

Independence standards - disallowed services (continued)

	AICPA	SOX/PCAOB/SEC	DOL
Actuarial services	X if significant subjectivity and material; otherwise C	X	
Management responsibilities (officer, director, management role)	X	X	X
HR / executive recruiting	C (X: hiring, key-position searches, rankings, reference checks, negotiating)	X	
Internal audit	C (assisting when management directs the function and evaluates findings; managing the function: X)	X	
Service as broker, dealer, or investment banker	X	X	X

Independence standards - disallowed services (continued)

	AICPA	SOX/PCAOB/SEC	DOL
Investment advisor	C for advice; X for making decisions, executing trades or custody	X	X
Legal services	C (representing the client in court, e.g., a tax dispute: X)	X	
Expert witness services	X	X	
Unpaid fees	X if significant and over 1 year old at current report date, unless safeguards (e.g., partial payment, payment plan) reduce threat; N/A in bankruptcy	X	

Independence standards - disallowed services (continued)

	AICPA	SOX/PCAOB/SEC	DOL
Actual or threatened litigation	X if audit-related or material; immaterial unrelated disputes do not impair	X	
Contingent fees (audit, review, compilation used by third parties without an independence disclosure, examination of prospective financial information; preparing tax returns)	X	X	
Significant gifts from clients	X	X	
Tax services related to confidential or aggressive tax transactions		X	
Tax services to persons in a financial reporting oversight role at an issuer audit client, or their immediate family (PCAOB Rule 3523)		X	
Audit partner compensated for selling that audit client services other than audit, review, attest		X	

Acts discreditable to the profession & client records & confidential client information rule

Per the AICPA, the following are acts that are considered discreditable to the profession if taken by a CPA: Retaining client records after the client requests them, Discrimination and harassment, Soliciting or disclosing CPA Exam questions, Failing to file tax returns or remit payroll taxes, Negligently making materially false entries, Failing to follow governmental requirements or professional standards, False or misleading promotion of services, & Disclosing confidential information without consent.

The consequences of breaching the AICPA's rules governing acts discreditable to the profession can be very severe. AICPA discipline can suspend or expel a member from the Institute. State boards of accountancy, under applicable law, determine suspension or revocation of a CPA license and other practice sanctions.

The AICPA client records rule (ET 1.400.200) governs client records. The confidential client information rule (ET 1.700.001) is designed to protect the confidentiality of client information. The rule prohibits disclosing confidential client information without the client's specific consent.

The rule applies to all nonpublic client information, regardless of the medium in which it is stored (e.g., paper, electronic, etc.). Client information includes, but is not limited to, information about a client's financial condition, tax status, and business affairs.

The rule prohibits the unauthorized disclosure of client information. Unauthorized disclosure includes, but is not limited to, disclosing client information to third parties without the client's consent, or disclosing client information to persons who are not authorized to receive it.

The Confidential Client Information Rule prohibits a member in public practice from disclosing confidential client information without the client's specific consent, subject to its stated professional, legal, practice-review, and ethics-investigation exceptions. It does not create a general duty to verify and continuously update every item of client information.

The rule applies to members in public practice; members in business and other members have parallel confidentiality duties (ET 2.400.070; 3.400.070).

Acts discreditable to the profession & client records & confidential client information rule (continued)

- Client records: return client-provided records on request even if fees are unpaid; member-prepared records and work products may be withheld for unpaid fees for that work (state law may be stricter); working papers belong to the member. Respond as soon as practicable, no later than 45 days absent extenuating circumstances (ET 1.400.200).
- No consent needed to comply with professional standards, a valid subpoena or summons, laws and regulations, peer review, or AICPA or state ethics investigations.
- Third-party service providers (including cloud or AI tools): get the client's specific consent, or have a confidentiality agreement and reasonable assurance the provider protects the information (ET 1.700.040).

AICPA rules summary

Rule	Notes	Public Practice	Member in Business	Retired / Unemployed
Independence	Impaired: Direct financial interest Significant unpaid fees over 1 year old (unless safeguards, e.g., payment plan, reduce threat) Management position Making hiring decisions for the client Litigation with client (audit-related or material)	✓		
Integrity & Objectivity	Objective; conflicts identified, disclosed and consented to, or the service is declined	✓	✓	
General Standards	Professional Competence Due Professional Care Adequate Planning & Supervision; Sufficient Relevant Data	✓	✓	
Compliance with Standards		✓	✓	
Compliance with Accounting Principles		✓	✓	

AICPA rules summary (continued)

Rule	Notes	Public Practice	Member in Business	Retired / Unemployed
Confidential Client Information	Allowed if client consent Quality control review Subpoenaed Practice buyer if confidentiality is assured	✓		
Contingent Fee	Allowed: compilations not expected to be used by third parties, or whose report discloses lack of independence Representing a client in an IRS examination of a tax return	✓		
Acts Discreditable	Retaining client records Discrimination Failure to follow standards Negligently making materially false entries Failure to file timely tax return or remit payroll taxes Soliciting or disclosing CPA Exam questions Misleading claim on ability to perform services Disclose confidential information without consent	✓	✓	✓
Advertising/Solicitation		✓		

AICPA rules summary (continued)

Rule	Notes	Public Practice	Member in Business	Retired / Unemployed
Commissions and Referral Fees	Commissions: prohibited for audit, review, third-party compilation not disclosing lack of independence, and prospective-information examination clients; otherwise disclose. Referral fees: disclose to the client.	✓		
Form and Organization	CPAs must hold a majority (more than 50%) of financial interests and voting rights; non-CPA owners allowed with conditions. A firm may call itself Members of the AICPA only if all its CPA owners are AICPA members.	✓		

Recap of PCAOB & SEC requirements

- According to SOX Title II, Auditor Independence, the lead audit partner must rotate off the audit every **5** years.
- According to SOX Title I, Public Company Accounting Oversight Board, audit documentation must be maintained for **7** years.
- According to the SEC, other audit partners should rotate off the audit engagement after no more than **7** years.
- According to the SEC, lead partners and concurring partners are subject to a 5-year "time-out" period before returning to an engagement.
- Under SEC rules, covered persons include the audit engagement team and individuals within the audit chain of command. This includes any other partner, principal, shareholder, or managerial employee of the firm who provided **10** or more hours of non-audit services to the audit client.

Recap of PCAOB & SEC requirements (continued)

- SEC 1-year cooling-off: a former member of an issuer's audit engagement team cannot take a financial reporting oversight role at that issuer unless they were off the audit team for the one-year period before audit procedures began for the period that includes the hire date.
- The PCAOB will conduct annual inspections of registered public accounting firms that regularly provide audit reports for more than **100** issuers.
- For credit cards and overdraft accounts with a lending institution that is an attest client, a covered member may owe an aggregate current balance of $10,000 or less, considering the payment deadline and grace period.
- AICPA (not SEC): CPAs must hold a majority of the attest firm's financial interests and voting rights.
- Auditors of nonissuers must maintain audit documentation for at least **5** years from the report release date.

- Auditors of nonissuers must assemble final audit documentation within **60** days following the report release date.
- For PCAOB audits, assemble the final audit file within 14 days after the report release date.

- SEC covered persons also include partners in the lead audit partner's office, and other partners, principals, shareholders or managerial employees who provide or expect to provide 10 or more hours of non-audit services.
- Other audit partners: 7 years on, 2-year time-out.

Threats to an auditor’s independence per GAGAS

Self-interest threat

Threat that a financial or other interest will influence an auditor’s judgment or behavior.

Management participation threat

Threat that an auditor takes on a management role or functions on behalf of the entity under audit.

Bias threat

Threat that an auditor will be influenced by convictions such as politics or ideology which impairs objectivity.

Threats to an auditor's independence per GAGAS (continued)

Self-review threat

Threat that an auditor who provided nonaudit services will not appropriately evaluate those prior judgments or services when forming a judgment significant to the GAGAS engagement.

Undue influence threat

Threat that external influences will impact an auditor's independence and objectivity.

Familiarity threat

Threat that a close or long relationship with entity management or staff will lead an auditor to lose objectivity.

Threats to an auditor's independence per GAGAS (continued)

Structural threat

Threat that an audit organization's placement within a government entity, in combination with the structure of the government entity being audited, will impact the audit organization's ability to perform work and report results objectively.

GAGAS conceptual framework: identify threats, evaluate significance, apply safeguards to eliminate or reduce them to an acceptable level; if that is not possible, decline or end the engagement.

Review of GAAS vs GAGAS vs Single Audits

<table>
<tr><th>GAAS</th><th>GAGAS</th><th>Single Audit</th></tr>
<tr><td colspan="3">Reporting on fair presentation of an entity’s financial statements as a whole.</td></tr>
<tr><td colspan="2">If federal awards expended are less than $1,000,000 in a fiscal year, a Single Audit is not required; the auditor applies GAAS (and, when engaged, GAGAS).</td><td></td></tr>
<tr><td></td><td colspan="2">Adds reports on internal control over financial reporting and on compliance with laws, regulations, contracts and grant agreements.</td></tr>
<tr><td></td><td></td><td>Non-Federal entities (governments, NFPs) that expend $1,000,000 or more in federal awards in a fiscal year are subject to a Single Audit (or, when permitted, a program-specific audit).</td></tr>
</table>

Review of GAAS vs GAGAS vs Single Audits (continued)

GAAS	GAGAS	Single Audit
		Evaluation of materiality for each major program.
		Opinion on compliance for each major program, plus a report (no opinion) on internal control over compliance.
		Major programs: Type A threshold starts at $1,000,000 (higher for larger auditees); audit enough programs to cover at least 40% of federal awards expended (20% for a low-risk auditee).

Introduction to integrated audits & top-down approach

The objective of an integrated audit is for the auditor to express an opinion on both the financial statements and the effectiveness of a company's internal controls over financial reporting.

Integrated Audit vs Non-Integrated Audit: A non-integrated audit is a financial statement audit only (opinion on the FS); an integrated audit also gives an opinion on ICFR. The scope, procedures, and purpose of an integrated audit are more extensive than a normal audit. An opinion is given for the internal controls which requires more extensive testing and procedures.

Other references to an integrated audit are “an engagement to audit internal controls” or “reporting on internal controls over financial reporting”.

The auditor should modify the report on ICFR if any of the following conditions exist:

1. One or more material weaknesses exist.
2. Elements of management's report are incomplete or improperly presented.
3. There is a limitation on the scope of the engagement.
4. The auditor decides to refer to the report of another auditor (referred-to auditor) as the basis, in part, for the auditor's own opinion.
5. There is other information contained in management's report.
6. Management's annual certifications are misstated.

A material weakness requires an adverse ICFR opinion.

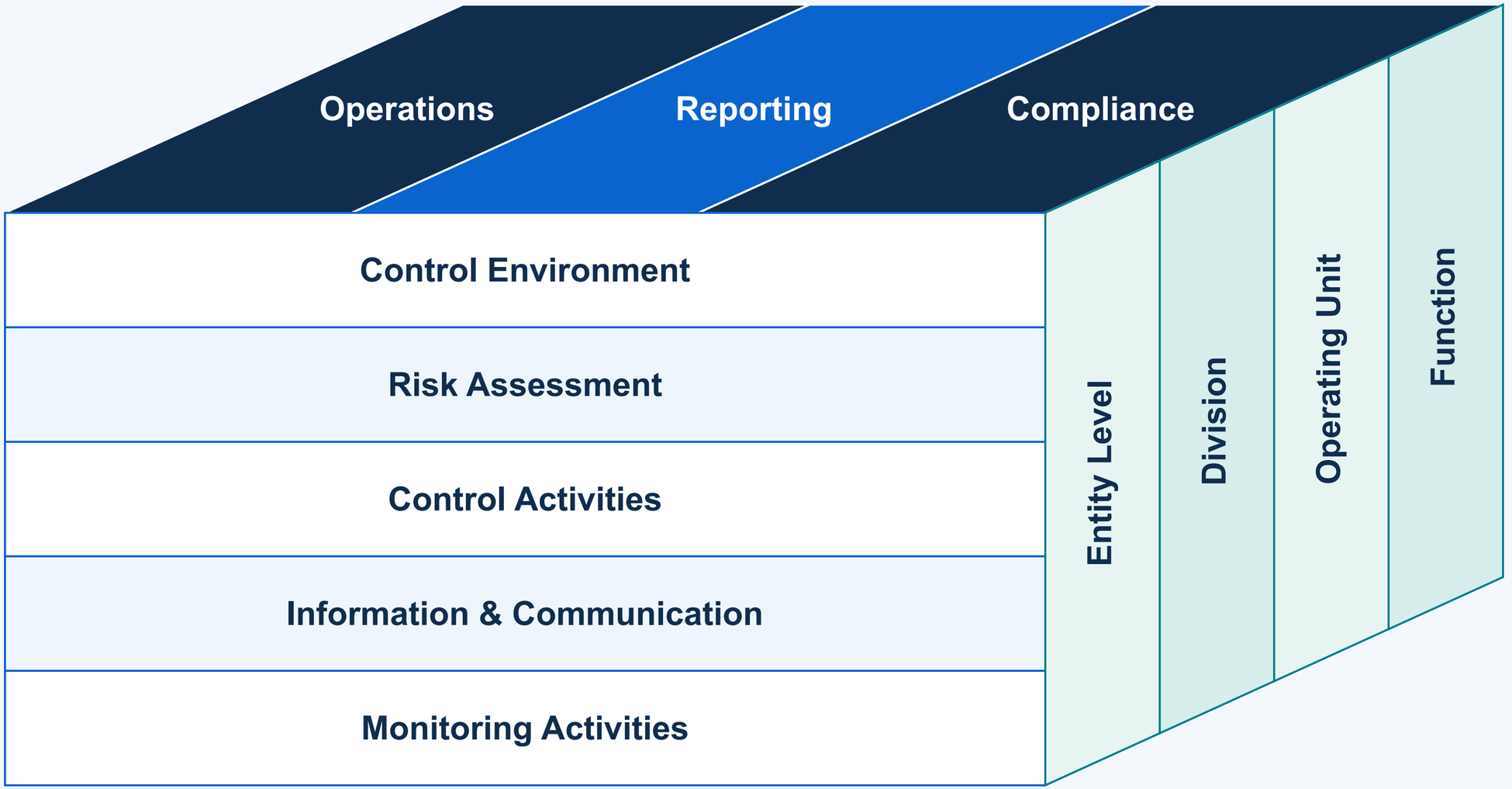
Introduction to integrated audits & top-down approach (continued)

1. A top-down approach is a method to determine which controls should be tested.
2. It begins at the financial statement level with overall ICFR risks, then moves to entity-level controls, and finally to significant accounts and disclosures and their relevant assertions. It is referred to as top-down as it begins with the highest level at the company and moves into the individual controls as it moves along.

Introduction to integrated audits & top-down approach (continued)



COSO cube


Operations
Reporting
Compliance
Control Environment
Risk Assessment
Control Activities
Information & Communication
Monitoring Activities
Entity Level
Division
Operating Unit
Function

The five components of the COSO internal control integrated framework

Control Environment

- Commitment to Ethics & Integrity
- Board Independence & Oversight
- Organizational Structure
- Commitment to Competence
- Accountability

Risk Assessment

- Specify Objectives
- Identify & Analyze Risks
- Consider Potential for Fraud
- Identify & Assess Changes

Control Activities

- Select & Develop Control Activities
- Select & Develop Technology Controls
- Deployment of Policies & Procedures

The five components of the COSO internal control integrated framework (continued)

Information & Communication

- Obtain & Use Information
- Internally Communicate Information
- Communicate with External Parties

Monitoring

- Ongoing & Separate Evaluations
- Communication of Deficiencies

The five components of COSO ERM

(a BAR topic; AUD tests COSO internal control)

Governance and Culture

- Exercises board oversight
- Establishes operating structure
- Defines desired culture
- Demonstrates commitment to core values
- Attracts, develops, and retains capable employees

Strategy and Objective-Setting

- Analyzes business context
- Defines risk appetite
- Evaluates alternative strategies
- Formulates business objectives

Performance

- Identifies risks
- Assesses severity of risk
- Prioritizes risk
- Implements risk responses
- Develops portfolio view

The five components of COSO ERM (continued)

Review and Revision

- Assesses substantial change
- Reviews risk and performance
- Pursues improvement in ERM

Information, Communication, and Reporting

- Leverages information and technology
- Communicates risk information
- Reports on risk, culture, and performance

SOC (System & Organization Controls) reports - comparing the reports

Report	What it reports on	Who uses it
SOC 1	Internal controls over financial reporting.	Management, user entity, & user auditor.
SOC 2	Security, availability, processing integrity, confidentiality or privacy controls.	Restricted to specified parties with enough knowledge of the system (service organization management, user entities, their auditors, prospective customers, regulators); often shared under NDA.

Type	What it reports on
SOC 1 Type 1	Design and implementation of controls.
SOC 1 Type 2	Design, implementation, and operating **effectiveness** of controls.

Here we are focusing on the Type 1 and Type 2 of SOC 1 reports. You need to know that SOC 2 reports have two types, and just like SOC 1 reports, SOC 2 reports also have a Type 1 (report on the design and implementation of controls) and a Type 2 (report on the design and operating effectiveness of controls). Understanding this distinction is important. SOC 1 reports cover ICFR which is a key topic in the AUD exam.

Type 1: description and suitability of design as of a date. Type 2: also operating effectiveness throughout a period.

SOC (System & Organization Controls) reports - auditor's responsibilities

When a SOC 1 service auditor's report is available, the user auditor may utilize the report in its assessment of the user entity's internal controls.

- **SOC 1 Type 1 Report**: A Type 1 Report may aid the user auditor in obtaining an understanding of controls. However, a Type 1 Report is provided when tests of the operating effectiveness of the service organization's controls were not performed, and therefore it does not provide the user auditor with a basis for reducing the assessment of control risk below maximum for areas of the entity's accounting that are affected by the service organization.
- **SOC 1 Type 2 Report**: A Type 2 Report provides the user auditor with **assurance** about the design, implementation, and operating **effectiveness** of the service organization's internal controls and therefore may provide evidence that would allow a reduction in the assessed level of control risk for areas of the entity's accounting that are affected by the service organization.

Alternatively, such evidence (to allow reduction in assessed risk) can be obtained directly by the user auditor, either by testing the user entity's controls over the service organization's activities, or by performing tests of controls at the service organization.

Before relying on a Type 2 report: check the period covered and any gap to year-end, the tests and results, complementary user entity controls, and the service auditor's competence and independence.

AUP report

AUP report includes:

- A description of the procedures performed (or reference thereto) and the related findings.
- Practitioner's findings.
- Identification of the responsible party and a statement that it is responsible for the subject matter. The responsible party and engaging party may differ.
- Statement that no assurance is provided.
- A statement that the engaging party has acknowledged that the procedures performed are appropriate for the intended purpose of the engagement.
- That the practitioner is required to be independent.
- Statement referring to standards established by the AICPA.

AUP report (continued)

- Statement that the practitioner was not engaged to and did not conduct an examination or review, does not express an opinion or conclusion, and that additional procedures might have revealed other matters.
- A statement that the report may not be suitable for any other purpose, and that the procedures may not address all items of interest to users, so users are responsible for deciding whether the procedures are appropriate for their purposes.
- A description of any specified materiality thresholds for reporting variances.
- That the engagement complied with SSAE standards.
- Identification of the engaging party; the firm's signature; the city and state where the report is issued.

The report date is determined based on the completion of the AUPs, not the delivery of the report, approval of the report, nor the client signature date.

In a **preparation** engagement, the CPA prepares financial statements based on information provided by management but does not express an opinion or provide assurance. No report is required, but each page of the statements must say that no assurance is provided (if that is not possible: issue a disclaimer, perform a compilation, or withdraw).

In a **compilation** engagement, the CPA compiles financial statements from management's data without verifying accuracy. The CPA issues a report stating that no assurance is provided but reads the statements to check for obvious errors or misstatements.

In a **review** engagement, the CPA performs inquiries and analytical procedures to provide limited assurance that no material modifications are needed. A review report is issued with negative assurance, but no opinion is expressed.

Unlike these engagements, an **audit** involves detailed testing and results in an opinion on the financial statements.

Predecessor & successor auditors

Compilations and reviews under the Statements on Standards for Accounting and Review Services (SSARS) do not require predecessor inquiry. Before accepting an initial audit when a predecessor auditor exists, the auditor requests management to authorize the predecessor to respond; if authorized, the auditor inquires about matters such as:

- Information that might bear on the integrity of management.
- Disagreements with management as to accounting principles, auditing procedures, or other similarly significant matters.
- Identified or suspected fraud and noncompliance with laws and regulations.
- Communications to management and those charged with governance regarding significant deficiencies and material weaknesses in internal control.
- The predecessor auditor's understanding as to the reasons for the change of auditors.

Review engagement procedures & reports

The following procedures are some of those that are conducted for a review engagement:

- Analytical procedures (a common MCQ trick is to list these as an option for compilations or preparations). These will include any comparisons of financial data and ratios such as:

  - Comparing financial statements and account balances with anticipated results in budgets and forecasts, and results from prior periods.
  - Analyzing relationships between the financial statements and ratios for patterns.

  - Inquiries about actions taken at meetings of stockholders, the board and its committees.
  - Inquire of management about related party transactions, going concern issues, account balances, restrictions on cash, procedures, and subsequent events; however, the reviewer may need to corroborate these results if the statements may be materially misstated.

Review engagement procedures & reports (continued)

A review does not involve obtaining an understanding of internal control, assessing fraud risk, or audit-style tests of details (inspection, observation, confirmation), so answer choices built on these are usually distractors in MCQs. If the accountant believes the statements may be materially misstated, additional procedures are required.

Review engagement reports state that:

- A review is substantially less in scope than an audit.
- A review consists primarily of applying analytical procedures to management's financial data and making inquiries of the client's management.
- Management is responsible for the preparation and fair presentation of the financial statements.
- The reviewer is not aware of any material modifications that should be made to the financial statements.
- The accountant is required to be independent and to meet other ethical responsibilities.

If the supplementary information was reviewed, the other-matter paragraph (or separate report) says it was subjected to review procedures and whether the accountant is aware of material modifications. If not reviewed, it says it was not audited or reviewed and no opinion, conclusion or assurance is provided.

The accountant may consider a reference on each reviewed financial-statement page, such as "See Independent Accountant's Review Report," to reduce unintended reliance if statements become detached from the report.

Engagement types recap

		Audit	Review	Compilation	Preparation	None
1	The accountant is required to be independent because assurance is provided.	X	X			
2	For an audit, document agreed terms in an engagement letter or other written agreement. For preparation, compilation, and review engagements, the written agreement is signed by the accountant or firm and management or those charged with governance.	X	X	X	X	
3	CPA should perform cutoff tests on sales and purchase transactions.	X				
4	CPA should understand the applicable financial reporting framework and significant accounting policies.	X	X	X	X	
4a	CPA should obtain knowledge of the entity's business and industry practices.	X	X			
5	CPA should design and perform analytical procedures and make inquiries in order to obtain limited assurance.		X			
6	CPA does NOT need to obtain an understanding of internal control for purpose of assessing control risk.		X	X	X	

Engagement types recap (continued)

		Audit	Review	Compilation	Preparation	None
7	CPA should use analytical procedures as a basis for inquiry about relationships that appear unusual.	X	X			
8	CPA should read the financial statements for any indications of departure from the applicable framework.	X	X	X		
9	CPA should verify that the financial statements agree or reconcile with the accounting records.	X	X			
10	When using a special purpose framework, the report should include a separate paragraph stating that the financial statements are prepared in accordance with the particular special purpose framework.	X	X	X		

Engagement types recap (continued)

		Audit	Review	Compilation	Preparation	None
11	If not independent, the report should so indicate with the use of an extra paragraph but the rest of the report would be standard.			X		
12	When the financial statements omit substantially all the disclosures, the report should include a paragraph pointing out that fact but would otherwise be a standard report.			X		
13	When the CPA becomes aware of a material departure from the framework, the CPA discloses the departure in a separate paragraph (audit and review: a 'Basis for Qualified/Adverse' paragraph with a modified opinion or conclusion). In a preparation, the departure is disclosed in the statements.	X	X	X		
14	The CPA is required to assess the risk of fraud.	X				
15	The CPA should test the accounting records by obtaining sufficient appropriate audit evidence.	X				
16	Inquire of related party transactions.	X	X			

Engagement types recap (continued)

		Audit	Review	Compilation	Preparation	None
17	The CPA should send a letter of inquiry to the entity's external legal counsel (unless no litigation, claims or assessments are identified).	X				
18	A management representation letter is NOT required.			X	X	
19	CPA should confirm accounts receivable unless the balance is immaterial, confirmation would be ineffective, or assessed risk is low and other procedures address it.	X				
20	CPA should review subsequent bank statements for evidence of cash deposits.	X				
21	CPA's report should include the scope limitation that led to a step down in level of service.					X

Engagement procedures

Preparation (No Assurance, Non-attest)

Establish an Understanding With the Client (Engagement Letter is Presumptively Mandatory)

Knowledge of Accounting Principles / Practices

Understand the framework and significant accounting policies

Evaluate and Document Results

Compilation (No Assurance, Attest)

Read the Financial Statements

Create Appropriate Report

Includes all components of a preparation

Review (Limited/Negative Assurance, Attest)

Knowledge of the entity's business

Inquiries (Within Organization)

Analytical Procedures

Obtain Client Representation Letter

Includes all components of both a compilation and a preparation

Requirements of each engagement type

Engagement Type	Agreed-Upon Procedures	Examination (assertion-based or direct)
Standard	SSAE	SSAE
Assurance Level	None	High
Assurance Type	No Assurance	Positive (opinion)
Opinion	No - List of findings	Yes
Restricted Use	Optional alert (general use allowed)	When criteria are suitable only for, or available only to, specified parties (or only oral representations are obtained); financial projections are always restricted, forecasts may be general use.
Independence Required	✓	✓
Report Issued	✓	✓
Procedures	Agreed to by the engaging party; practitioner may develop or assist	Inspection, observation, confirmation, recalculation, reperformance, analytical procedures and inquiry
Disclaim an Opinion	We did not perform examination or review. Accountant does not express an opinion.	Disclaimer if a scope limitation is pervasive

Requirements of each engagement type (continued)

Engagement Type	Review (A review of the MD&A would follow SSAE)	Financial Statements
Standard	SSAE or SSARS	SSARS
Assurance Level	Limited	Limited
Assurance Type	Limited (negative)	Limited (negative)
Opinion	No - Conclusion	No - Conclusion
Restricted Use	SSAE: alert when criteria are suitable only for, or available only to, specified parties. SSARS: restricted only for a contractual or regulatory basis.	General use; restricted only for a contractual or regulatory basis.
Independence Required	✓	✓
Report Issued	✓	✓
Procedures	Analytical Procedures & Inquiry of management	Analytical Procedures & Inquiry of management
Disclaim an Opinion	Review less in scope than an audit. Accordingly we do not express opinion.	Review less in scope than an audit. Accordingly we do not express opinion.

Requirements of each engagement type (continued)

Engagement Type	Interim Reviews
Standard	SAS (AU-C 930) for nonissuers when the auditor audits the annual FS (latest annual FS audited by it or a predecessor); PCAOB AS 4105 for issuers; otherwise SSARS (AR-C 90)
Assurance Level	Limited
Assurance Type	Limited (negative)
Opinion	No - Conclusion
Restricted Use	General use; restricted only for a contractual or regulatory basis.
Independence Required	✓
Report Issued	✓ (PCAOB: only if referenced in a filing)
Procedures	Analytical Procedures & Inquiry of management
Disclaim an Opinion	Review less in scope than an audit. Accordingly we do not express opinion.

Requirements of each engagement type (continued)

Engagement Type	Audit	Audit
Standard	SAS	GAGAS
Assurance Level	High	High
Assurance Type	Positive (opinion)	Positive (opinion)
Opinion	Yes	Yes
Restricted Use	General use unless restriction is needed; then add an other-matter (OM) paragraph	General use unless restriction is needed; then add an other-matter (OM) paragraph
Independence Required	✓	✓
Report Issued	✓	✓
Procedures	Internal Control & Substantive Tests	Internal Control & Substantive Tests
Disclaim an Opinion	N/A	N/A

Requirements of each engagement type (continued)

Engagement Type	Preparations	Compilations
Standard	SSARS	SSARS
Assurance Level	None	None
Assurance Type	No Assurance	No Assurance
Opinion	No	No
Restricted Use	N/A	Projections; contractual/regulatory basis FS
Independence Required	No	No - permitted
Report Issued	Not required	✓
Procedures	Prepare FS from records; no verification	Read the statements for obvious material misstatements; no analytical procedures or inquiry required.
Disclaim an Opinion	N/A	Accountant does not express an opinion.

Requirements of each engagement type (continued)

Engagement Type	Prospective financial information	Consulting Services	Tax Work
Standard	Examination (reasonable assurance, opinion) or agreed-upon procedures (findings) under SSAE; preparation or compilation under SSARS; never a review.		
Independence Required	Examination or agreed-upon procedures: Yes. Compilation: No, but the accountant must disclose the lack of independence. Preparation: No.	No	No

Examinations may be assertion-based (AT-C 205) or direct (AT-C 206; not for prospective financial information). In a direct examination the practitioner measures the subject matter against the criteria; no written assertion is required.

Engagement types recap: comparison

	Preparation Engagement	Compilation Engagement	Review Engagement			Audit Engagement
	SSARS		SSARS	SAS	PCAOB	
Level of Assurance	None		Limited			Reasonable
Entities	Nonissuers only		Nonissuers	Nonissuers: Interim FS	Issuers: Interim FS	Nonissuers/Issuers
Knowledge Required	Understanding of the applicable financial reporting framework and significant accounting policies		Same as compilation plus increased knowledge of client's business			Extensive knowledge of economy, industry, and client's business
Inquiry and Analytical Procedures Required	None unless information is questionable		Inquiries of internal personnel; analytical procedures			Inquiries of external parties and internal personnel Analytical procedures Audit procedures

Engagement types recap: comparison (continued)

	Preparation Engagement	Compilation Engagement	Review Engagement			Audit Engagement
	SSARS		SSARS	SAS	PCAOB	
GAAP Disclosure Omitted	May omit, but need to disclose in the financial statement	May omit substantially all; report says so	All are required or modify review report			All are required or "qualified/adverse" opinion
GAAP Departures	May depart from GAAP, but need to disclose in the financial statement	Modify report to discuss GAAP departure	SSARS: qualified (material) or adverse (pervasive) conclusion, with a basis paragraph. SAS/PCAOB interim: modify report to describe the departure.			Modify report; "qualified/adverse" opinion
Independence	Not required (non-attest engagement)	Not required but disclosure is required	Required			Required
Engagement Letter	Presumptively mandatory	Presumptively mandatory	Presumptively mandatory			Presumptively mandatory

Engagement types recap: comparison (continued)

	Preparation Engagement	Compilation Engagement	Review Engagement			Audit Engagement
	SSARS		SSARS	SAS	PCAOB	
Representation Letter	Not required		Required			Required
Understanding of Internal Control	Not required	Not required (no test work)	Not required (no test work)	Required		

Engagement types recap: comparison (continued)

	Preparation Engagement	Compilation Engagement	Review Engagement			Audit Engagement
	SSARS		SSARS	SAS	PCAOB	
Errors and Fraud Detection	Only obvious errors	Only obvious errors found when reading financial statements	Limited assurance: inquiry and analytical procedures, plus more work when the statements may be materially misstated.			Must be designed to provide reasonable assurance of detecting material misstatement, whether due to fraud or error.
FS Reported on (BS/IS/RE/CF)	One or more financial statements may be prepared	One or more financial statements allowed to be reported on	One or more financial statements allowed if scope of inquiry and analytical procedures have not been restricted			One or more financial statements allowed if scope of audit is not limited and all necessary procedures are applied

Engagement types recap: comparison (continued)

	Preparation Engagement	Compilation Engagement	Review Engagement			Audit Engagement
	SSARS		SSARS	SAS	PCAOB	
Communication with Predecessor	Not required		Not required	Required		Required
Subsequent Event Inquiries			Required			

Assurance provided in compliance engagements

Type of Engagement	Standards	Assurance Provided
Compliance report in connection with audited financial statements	Auditing standards (SAS)	Negative assurance
Agreed-upon procedures	Attestation standards (SSAE)	No assurance
Examination	Attestation standards (SSAE)	Reasonable assurance

Negative assurance means the CPA states that nothing came to its attention. In compliance reporting it appears in an AU-C 806 report on compliance with contractual or regulatory requirements in connection with audited financial statements. A compliance examination gives reasonable assurance; agreed-upon procedures give findings only. Reasonable assurance is the level of assurance which an auditor provides in their opinion on the financial statements. Reasonable assurance requires the auditor to perform audit procedures to obtain sufficient and appropriate audit evidence to express an opinion on the financial statements. It is a higher level of assurance than negative assurance.

Assurance provided in compliance engagements (continued)

- A compliance audit (AU-C 935, for example a single audit) gives an opinion on compliance. Negative assurance on compliance with contracts or regulations in connection with audited financial statements is the narrower AU-C 806 report. A review of compliance under the attestation standards (SSAE) is not allowed.

Types of attestation & compliance engagements

Service	Standard	Engagement Type	Restricted Use
Prospective Financial Statements	SSAE	Examination	
Financial Forecast			General Use Allowed
Financial Projection			✓
Pro Forma Financial Statements	SSAE	Examination or Review	

Prospective information can be examined or subjected to agreed-upon procedures under the attestation standards (SSAE), or prepared or compiled under the accounting and review standards (SSARS). It cannot be reviewed. Forecasts may be general use; projections are restricted use.

Types of attestation & compliance engagements (continued)

Service	Standard	Engagement Type	Restricted Use	Assurance Type	Caveats
Compliance	SAS	Audit	✓	Negative assurance only	Must have audited FS
	SSAE	Examination		Reasonable Assurance	
		Agreed-Upon Procedures		None	
MD&A		Examination or Review			
Service Organizations		Examination			

Assurance type: examination = reasonable assurance (opinion); review = limited assurance (conclusion); agreed-upon procedures = no assurance (findings). SAS compliance row = AU-C 806 report with audited FS; an AU-C 935 compliance audit gives an opinion. SOC 1 reports are restricted to service org management, user entities and their auditors.

Types of financial information

		Basic Financial Statements	Area Directly Affected by Existing FASB Standards	Financial Reporting	All Information Useful for Investors and Creditors
Financial Statements	• Balance Sheet • Income Statement • Statement of Cash Flows • Statement of Equity	✓	✓	✓	✓
Notes to Financial Statements	• Accounting Policies • Contingencies • Inventory Methods • Number of Shares Outstanding	✓	✓	✓	✓
Supplementary Information	• Changing Prices Disclosures • Oil and Gas Reserves Information		✓	✓	✓
Other Means of Financial Reporting	• MD&A • Letters to Stockholders			✓	✓
Other Information	• Analysts' Reports • Economic Statistics				✓

Treatment of FS, RSI & other information

Document	Treatment
Balance Sheet	Auditing procedures
Income Statement	Auditing procedures
Required supplementary information (RSI)	Limited procedures
Summary of executive level compensation	Read and consider for material inconsistency with the financial statements and with knowledge obtained in the audit; stay alert for other misstatements (other information in the annual report).
Net Income Summary	Read and consider for material inconsistency with the financial statements and with knowledge obtained in the audit; stay alert for other misstatements (other information in the annual report).

Other and supplementary information examples

- Other information in the annual report (AU-C 720): read and consider, no assurance. Required supplementary information (AU-C 730): limited procedures, separate report section, no assurance. Supplementary information (AU-C 725): audit procedures and an 'in relation to' opinion.

Requirements of an auditor & professional skepticism

An auditor must:

- Maintain professional skepticism and exercise professional judgment throughout the audit.
- Comply with ethical requirements.
- Plan the audit work and properly supervise any others who work on the audit.
- Have competence and capability to perform an audit.
- Work to express an opinion on the financial statements based on the audit using sufficient appropriate evidence to obtain reasonable assurance.

AU-C 220 and QM Section 10 require the engagement partner to ensure the team has, or obtains, appropriate industry knowledge before performing the audit.

An auditor does not need industry knowledge or experience before accepting the audit; the team can obtain it before the work that needs it, or use a specialist.

An auditor commonly: Makes recommendations to a client on how to improve the internal control environment.

Requirements of an auditor & professional skepticism (continued)

To show professional skepticism means:

- Corroborating evidence and management's explanations.
- Being alert to anything that may indicate misstatement due to error or fraud.
- Considering the reliability of information that will be used as audit evidence.
- Not having an accusatory attitude toward the client.
- Utilizing third party confirmations as support for management's information.
- Working toward audit procedures that will lead to reliable audit evidence.
- Critically assessing audit evidence.

A widely used model describes six traits of professional skepticism: Having a questioning mind, Suspending judgment, Searching for knowledge, Understanding interpersonal relationships, Self-determination, and Self-confidence.

Watch for biases that weaken skepticism: availability, confirmation, groupthink, overconfidence, anchoring and automation bias. Seek contrary evidence instead of accepting a first belief or tool output.

Professional judgment

To have professional judgment means utilizing skills, experience, and training to work through audit difficulties and avoid audit pitfalls in each unique audit.

Professional judgment is developed through acquiring skills, obtaining experience, and training.

Using professional judgment allows the auditor to avoid roadblocks when the standard audit procedures do not account for something.

For example, for a complex estimate on new technology, the auditor still applies AU-C 540 and the reporting framework, using professional judgment (and a specialist if needed) to evaluate management's method, assumptions and data.

Accept or continue an audit only when the audit preconditions exist and the auditor and management, and those charged with governance when appropriate, share an understanding of the engagement terms.

Professional judgment (continued)

Reasons to not accept an engagement:

- Scope limitations imposed by management or those charged with governance that are expected to cause a disclaimer (the auditor may accept only if law or regulation requires it).
- Poor professional reputation of the client or the client's management lacking integrity.
- Substantial risk of the client and/or its management falsifying or manipulating financial information.
- Records so inadequate that sufficient appropriate evidence is unlikely to be available. Weak internal control alone is not a reason to decline: the auditor can use a substantive approach. To decide on an opinion, evidence is needed!
- Lack of audit firm or auditor independence.
- Inability of the firm to meet required deadlines.
- Lack of necessary audit staff.

If an auditor does not have experience in the prospective client's field, this is not a reason to decline the engagement. The auditor can gain the experience or work with a specialist.

Engagement terms

To be discussed with management/the client before conducting audit fieldwork:

- The auditor has a responsibility to obtain reasonable assurance on whether or not the financial statements are free from material misstatement from unintentional error and/or deliberate fraud.
- An understanding with the client that client employees will be of assistance in obtaining financial records.
- Management has a responsibility to:

- Correct financial statements if the auditor discovers material misstatements.
- Prepare and fairly present the financial statements.
- Properly design, implement, and maintain internal controls.
- Provide the auditor with all financial information and employees necessary for the audit.

Engagement terms (continued)

- An understanding of the objectives and limitations of the engagement.
- The responsibilities of both the management and the auditor.
- Arrangements involving a predecessor auditor.
- Preconditions for an audit: an acceptable financial reporting framework, and management's acknowledgment of the responsibilities listed above (including access to all relevant information, additional information requested, and people).

Auditor's and management's responsibilities

Auditor's Responsibility	Management's Responsibility
Obtaining reasonable assurance whether the financial statements are free of material misstatement	Preparing the financial statements
Assessing audit risk	Providing employee assistance to the auditor
Following GAAS	Prepare the financial statements using the applicable financial reporting framework.
Obtaining an understanding of internal controls	Establishing internal controls
Evidence on laws with a direct effect on material amounts; specified procedures for other laws	Following laws and regulations
Obtaining the representation letter	Providing a representation letter
Timing of the audit: agreed with management, set by the auditor	

Engagement letter

An engagement letter is used for any type of engagement; however, we will focus more on an overall audit engagement letter for the exam. Many items listed in the letter would still be relevant for other engagement types such as outlining procedures to be completed and statements on responsibility. Engagement letters are a great way to reduce the risk of a misunderstanding between the auditor and client in an engagement as it documents all agreed-upon terms.

This letter outlines and includes the following items:

- The auditor's responsibilities.
- Management's responsibility for fairly presenting the financial statements.
- Management's responsibility to provide the auditor with required written representations.
- Management's responsibility for designing, implementing and maintaining internal control relevant to preparing the financial statements.
- A statement that management has a responsibility to provide the auditor with all relevant financial records (no scope limitations).
- Fee and billing conditions.
- Understanding between the auditor and client on the general procedures to be performed, limitations, objectives, and responsibilities, and parties involved in the audit such as the client's internal audit team.

Engagement letter (continued)

- A client signature and date.
- The applicable financial reporting framework and the expected form and content of reports (noting a report may differ).
- A statement that, because of inherent limitations of an audit and of internal control, some material misstatements may not be detected even in a properly performed audit.

Required audit documentation

Audit documentation exists to support the auditor's report and opinion and to support that the audit was performed in accordance with GAAS. Documentation should show who performed the work and when, and who reviewed it, when, and the extent of review. The purpose of this documentation is to provide proof of work for the reasonable assurance that the financial statements are free from material misstatement.

Required documentation includes:

- A written engagement letter.
- Audit plan detailing the procedures necessary to accomplish an engagement's objectives including notes on the planning, conduct, and supervision of the audit.
- Critical audit correspondence (emails, letters, etc).
- Representation letters.
- Reconciliation of the accounting records to the financial statements.
- Findings that could result in a modification to the audit report.
- Auditor's assessment of the risk of material misstatement.
- Descriptions of the audit procedures to be performed.
- Justification for any departure from a relevant presumptively mandatory GAAS requirement and how alternative procedures achieved its intent.

Required audit documentation (continued)

- Significant findings and agreements.
- Other documentation may include confirmations, bank and account reconciliations.
- Documentation must let an experienced auditor with no previous connection to the audit understand the procedures, evidence, results, significant findings, conclusions and judgments, and how any inconsistent information was resolved.

The current & permanent files

Current File

- Current year documents
- Lead sheets
- Third party support
- Board meeting minutes
- Control tests
- Substantive tests
- Current year reconciliations

Permanent File

- Internal control flowcharts
- New client questionnaire
- Accounting policies
- Continuing significant matters
- Long term lease and debt agreements
- Relevant board meeting minutes
- Articles of incorporation
- Prior year important and relevant documents
- Engagement letters

Providing audit documentation to third parties

In the following cases, an auditor may provide audit documentation to third parties without the client's permission:

- A validly issued and enforceable subpoena or summons, or applicable laws and regulations.
- An authorized professional practice (peer) review.
- A complaint to or inquiry from the AICPA ethics division or a state CPA society or board of accountancy disciplinary body.
- Information necessary to initiate, pursue or defend an actual or threatened lawsuit or alternative dispute resolution proceeding (including the auditor's attorney or insurer).

Audit workpapers and report release dates

An auditor’s working papers are the principal means of audit documentation. The auditor or firm that completed the audit has ownership of the working papers, the same as how a tax preparer has ownership of tax workpapers used to prepare a tax return.

Per SOX 2002, all registered accounting firms are required to maintain working papers of issuer clients for 7 years. AU-C 230 requires 5 years for nonissuer clients.

Per SAS, auditors of nonissuers have 60 days after the report release date to complete the final audit file.

Per the PCAOB, auditors of issuers must assemble the final audit file within 14 days after the report release date.

The report release date is when the auditor grants the client permission to use the report.

After this time period has passed, no deletions can be made to the documentation until the retention period has passed (7 years for issuers, 5 years for nonissuers). The auditor may add documentation, amend, or modify the documentation, but any addition or change must document why, when, by whom, and (GAAS) who reviewed it.

Audit workpapers and report release dates (continued)

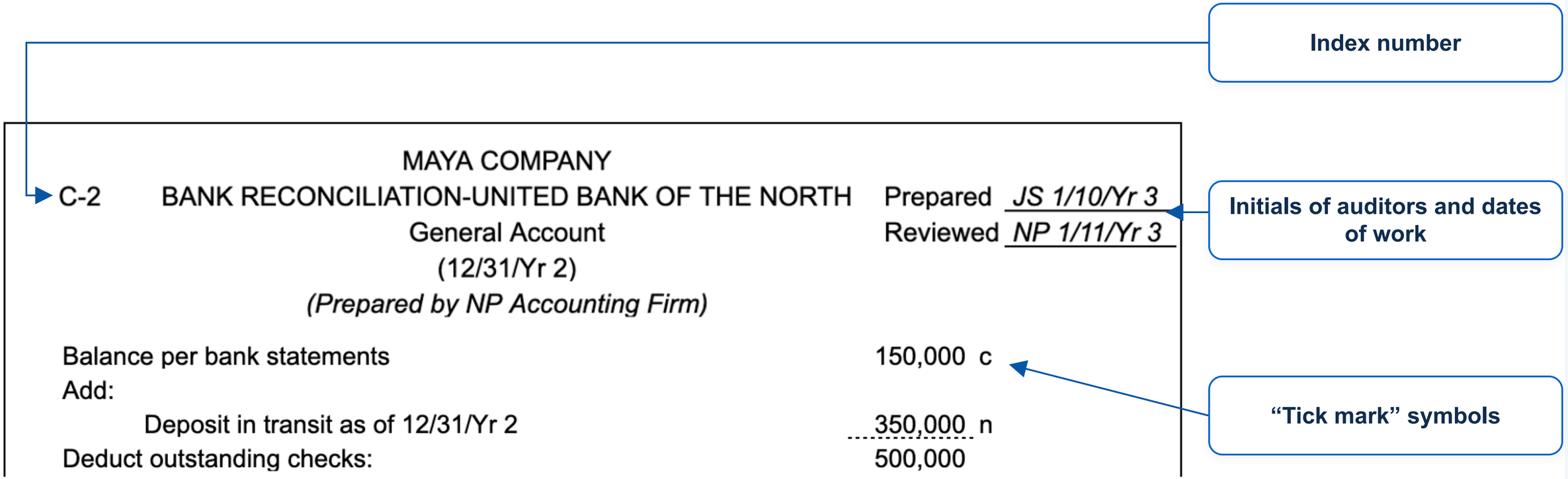
The audit report release date is when the retention period begins. Generally, this is the date when the report is delivered to the client and when the client is legally allowed to begin using the report and opinion.

Per PCAOB standards, an auditing firm cannot give the client permission to use the engagement report until the engagement quality reviewer provides concurring approval of issuance.

The earliest date for an audit report is the date that the auditor has obtained sufficient appropriate audit evidence to support the opinion.

Five and seven years are minimum retention periods; a longer legal requirement controls.

Example of an audit workpaper



MAYA COMPANY

C-2 BANK RECONCILIATION-UNITED BANK OF THE NORTH Prepared *JS 1/10/Yr 3*

General Account Reviewed *NP 1/11/Yr 3*

(12/31/Yr 2)

(Prepared by NP Accounting Firm)

Balance per bank statements	150,000 c
Add:	
Deposit in transit as of 12/31/Yr 2	350,000 n
Deduct outstanding checks:	500,000

Index number

Initials of auditors and dates of work

"Tick mark" symbols

Example of an audit workpaper (continued)

Date	No.	Payee		
12/10/Yr 1	957	Acme Hardware Inc.	5,000 α	
11/30/Yr 2	1283	Acme Hardware Inc.	45,000 ✔	
12/15/Yr 2	1374	General Supplies Co.	15,000 ✔	
12/28/Yr 2	1385	Chiefs Company	2,000 ✗	
12/30/Yr 2	1399	United Bank Payroll	8,000 ✔	
12/30/Yr 2	1422	Acme Hardware Inc.	30,000 ✔	
12/30/Yr 2	1485	Miller Utilities	20,000 ✔	
12/30/Yr 2	1598	Buffalo Hardware Company	25,000 ✔	
Total outstanding checks				150,000
Balance per book				350,000 *f*

Arithmetic footed

Cross-index to trial balance

7/B-1

Example of an audit workpaper (continued)

Note: Obtained cutoff bank statement 1/9/Yr 3.

f	Footed.
c	Confirmed by bank, standard bank confirmation.
n	Vouched to cutoff bank statement, deposit recorded by bank on 1/3/Yr 3. Vouched to duplicated deposit slip validated 1/03/Yr 3.
✔	Vouched to paid clean check cleared with cutoff bank statement.
✓	Vouched to statement from attorneys. Amount agrees.
α	Amount in dispute per controller. Confirmation from supplier claims liability of $5,000. See K-4 recommended adjustment.

Cross-index to other working papers

C-4

C-3

Explanations of audit work performed

Example of an audit workpaper (continued)

Information on Workpaper

- Name, date, purpose, page number.
- Procedures performed and conclusions reached by the auditor.
- Evidence that the audit complied with the applicable auditing standards and that the procedures, evidence, and conclusions support the report.
- Audit tickmark legend.
- Reviewers' initials.

Example of an audit workpaper (continued)

Tickmark legend

Ft Foots, without exception

Cft Crossfoots, without exception

Rx Recalculates, without exception
imm Clearly trivial difference; no further work

/1 total sent to fixed asset rollforward

/2 total sent to fixed asset register

/3 total sent to trial balance
1/ total from fixed asset rollforward
2/ total from fixed asset register
3/ total from trial balance

TB Agreed to trial balance, without exception

A Exception noted; difference explained in the workpaper

B Exception noted; proposed adjustment (see AJE)

Items completed during the planning stage

- Obtaining an understanding of the client's industry and business. Can work with a third party expert if needed. This includes touring the client's facilities, understanding accounting policies and procedures within the company, reviewing AICPA auditing guidelines for the particular industry, interviewing client employees and management, and more. Additionally, analytical procedures are performed during planning to enhance the auditor's understanding of the client's business.
- Determining preliminary evaluations of materiality, audit risk, and internal control.
- Considering any factors which may require an extension of the engagement, which in turn would increase the time and resources required to complete.
- Determining to what extent the client's internal auditors would be involved in the audit.
- Determining the audit testing timeline.
- Conducting a fraud brainstorming session.

Items completed during the planning stage (continued)

- Developing and documenting the overall audit strategy (scope, timing and direction) and the audit plan (risk assessment procedures, further audit procedures, and direction, supervision and review of the team), updated as needed throughout the audit. The plan should establish specific audit objectives relating to financial statement assertions and procedures in order to abide by GAAS.
- Determining the use of IT and automation on the audit.
- Considering specific financial statement accounts which are likely to contain misstatements (cash, overstated assets or revenues, estimates, understated liabilities).
- Reviewing prior-year audit documentation and the client permanent file.

The following items are those completed by the auditor during the testing stage:

- Testing controls' operating effectiveness (design and implementation are evaluated in planning) when relying on them or when substantive procedures alone are insufficient (always in an integrated audit).
- Evaluating the sufficiency and appropriateness of audit evidence.
- Performing substantive tests of details and analytical procedures.
- Evaluating the reasonableness of accounting estimates.
- Inquiries of third parties.
- Cutoff testing of sales and purchases.
- Evaluating audit sampling.
- Searching through client accounting records.
- Selecting invoices or purchase orders for testing.

Items completed during the testing stage (performing procedures) & conclusion stage (continued)

- Searching for unrecorded liabilities.

The following items are those completed by the auditor during the conclusions stage:

- Management representation letter is obtained.
- Prepare draft audit report.
- Communicate circumstances affecting the form and content of the report to those charged with governance (PCAOB audits: provide the draft report to the audit committee and discuss it).
- Issue the final audit report.
- Completion also includes final analytical procedures, uncorrected misstatements, subsequent events, going concern, written representations, governance communications and any required engagement quality review (AICPA: before dating; PCAOB: before release).

Types of materiality

An auditor should make preliminary materiality assessments during the planning stage of the audit. These assessments should be revised as appropriate throughout the audit.

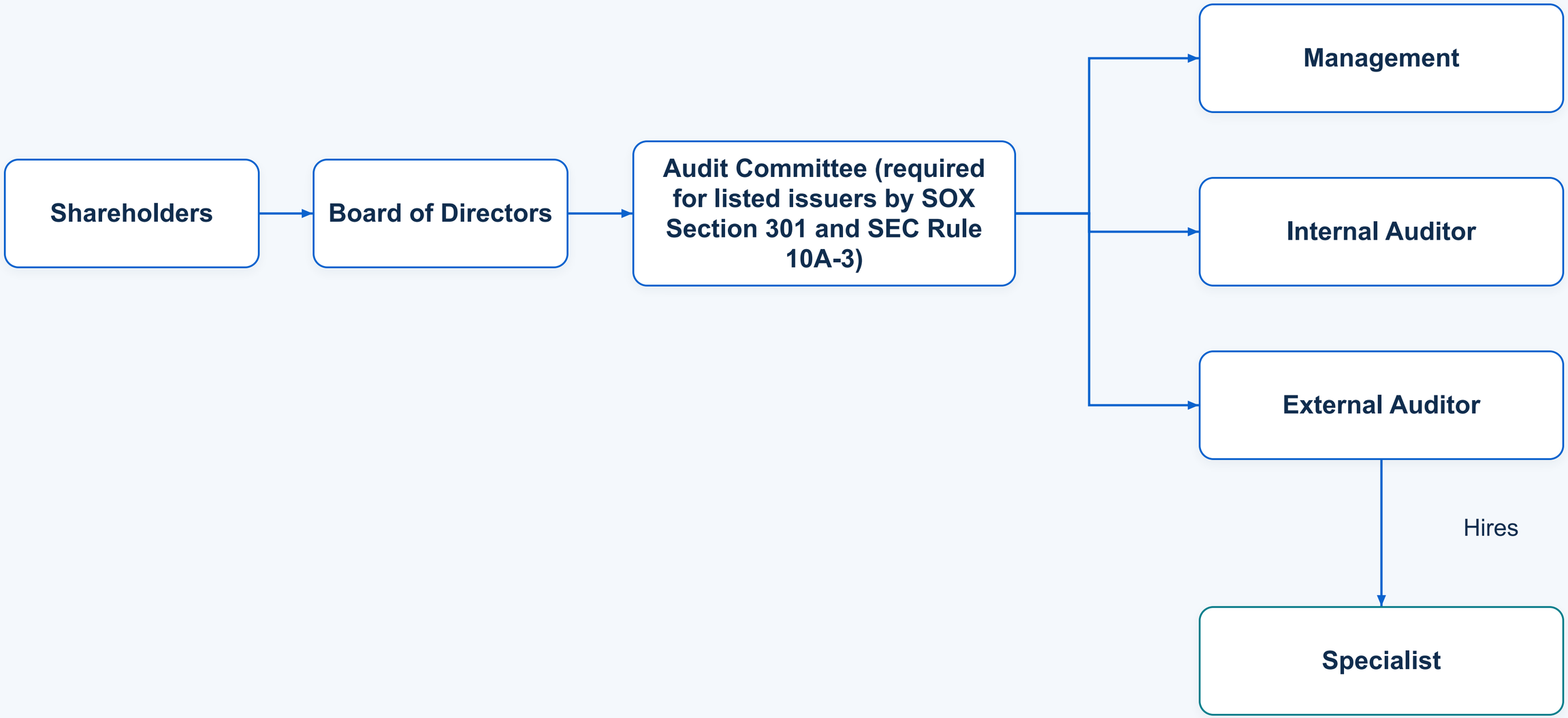
Overall Materiality - The amount of misstatement in the financial statements as a whole for which there is a substantial likelihood that it would influence the judgment of a reasonable user; set by judgment, and small misstatements can still be material by nature.

Performance Materiality - Set below overall materiality (and below any specific materiality) to reduce to an appropriately low level the risk that uncorrected plus undetected misstatements exceed materiality.

Specific Materiality - A lower materiality level for particular classes, balances or disclosures (for example, related party transactions or executive pay) where smaller misstatements could influence users. It is not the clearly trivial threshold; misstatements above clearly trivial are accumulated.

If the auditor sets overall materiality at $100,000 (for example, 5% of $2,000,000 pretax income; 5% is a judgment, not a rule), performance materiality might be about $70,000. If misstatements of related party disclosures above $20,000 would influence users, $20,000 is specific materiality for them, with performance materiality set lower. Tolerable misstatement for a sample is no more than performance materiality.

Client governance structure & client acceptance



Client governance structure & client acceptance (continued)

Inquiry of Predecessor Auditor

- Get management's authorization first; inquire about identified or suspected fraud and noncompliance; document the inquiries and results.
- Management Integrity
- Disagreements
- Reason for change
- Communications regarding fraud & noncompliance
- After acceptance, with management's authorization, review the predecessor's audit documentation (opening balances).

Engagement Letter

- Objective & Scope
- Responsibilities of Auditor
- Responsibilities of Management
- Inherent limitations of an audit
- Applicable framework
- Expected form and content of reports (which may differ)
- Timing
- Fees & billing arrangements

Client acceptance (continued)

Internal Audit Function

- Competence
- Who they report to
- Application of systematic & disciplined approach
- Evaluate the internal audit function's objectivity, competence and systematic, disciplined approach (including quality control). The external auditor makes all significant judgments and keeps sole responsibility for the opinion.

Use of Specialist

Understand:

- Field of expertise
- Competence & capabilities
- Objectivity

Functions of Audit Committee

- Oversee management's design and operation of the control environment and financial reporting controls.
- Select & appoint auditor
- Review the quality of the auditor's work
- Respond to auditor recommendations
- Help resolve disagreements related to accounting treatment of material items
- Bridge between auditor and BOD, it is a subgroup of the BOD

Using a specialist does not reduce the auditor's responsibility. Do not refer to the specialist in an unmodified opinion; a reference is allowed to explain a modification, or in a key audit matter description.

Client acceptance (continued)

- Firm quality management (Statement on Quality Management Standards (SQMS) 1) has eight components: risk assessment, governance and leadership, ethics, acceptance and continuance, engagement performance, resources, information and communication, monitoring and remediation. The engagement partner owns engagement quality (AU-C 220); SQMS 2 governs engagement quality reviews.

Client's internal audit function & types of misstatements

In assessing the competence of a client's internal audit function, an auditor would consider the internal audit team's:

- Compliance with professional internal auditing standards.
- Educational background and professional certifications.
- Quality of audit plans, procedures, and audit documentation.

In assessing the objectivity of a client's internal audit function, an auditor would consider the internal audit team's:

- Organizational level to which it reports and the organizational status of the director of internal audit.
- Policies barring internal auditors from auditing areas where relatives hold key positions.

Client's internal audit function & types of misstatements (continued)

Factual misstatements - Misstatements about which there is no doubt. These may include wrong accounts being used, wrong debits or credits, anything wrong with which there is no doubt.

Judgmental misstatements - Differences arising from management's judgments, including accounting estimates and the selection or application of accounting policies, that the auditor considers unreasonable or inappropriate. These may include unreasonable depreciation or liability accrual methods.

Projected misstatements - Projected misstatements are the auditor's estimate of total misstatement in the population, calculated by extrapolating the sample's misstatement rate (or amount). The auditor asks management to correct misstatements (for a projected misstatement, to examine the population and correct the actual misstatements found) and evaluates any uncorrected misstatements.

- The auditor also evaluates whether the internal audit function applies a systematic and disciplined approach, including quality control. If objectivity, competence or this approach is lacking, the auditor does not use its work.

Types of auditors in engagements

Aspect	Component Auditor	Referred-to Auditor	Other Auditor (PCAOB, issuer audits)	Specialist
Definition	An auditor who performs work on a component (e.g., a subsidiary) that contributes to a group financial statement audit.	An auditor who audits a component's financial statements and to whose report the group auditor makes reference in the group audit report; not part of the engagement team.	An auditor other than the lead auditor that performs audit procedures in an issuer audit (an engagement-team member, or that member's accounting firm)	An individual or firm with expertise in a field other than accounting or auditing, used to support the auditor’s work (e.g., actuaries, valuation experts).
Primary Role	Contributes audit work for a specific entity component (e.g., for a group audit).	Issues its own component report, which the group auditor references instead of using as audit evidence.	Performs work assigned by the lead auditor	Provides technical expertise in areas requiring specialized knowledge (e.g., complex valuations, actuarial estimates, legal matters).
Inclusion in Audit Report	Work is often integrated into the group auditor’s opinion, with no explicit mention unless required by standards.	Referenced in the group auditor's report (with the portion of the group it audited); named only with its express permission and only if its report is presented with the group auditor's report.	Not named (unless the lead auditor divides responsibility, which makes it a referred-to auditor)	Not referred to in an unmodified opinion unless required by law or regulation; may be referred to if relevant to a modified opinion. Any reference states it does not reduce the auditor's responsibility.

Types of auditors in engagements (continued)

Aspect	Component Auditor	Referred-to Auditor	Other Auditor (PCAOB)	Specialist
Scope of Work	Assigned and reviewed by the group auditor. Focuses on a specific component's financials. Operates under the direction and supervision of the group auditor, as part of the engagement team (AU-C 600).	Audits the component's financial statements and issues its own auditor's report; the group auditor makes reference to that report rather than using the work as audit evidence.	Performs audit procedures assigned by the lead auditor, who must inform, supervise and review its work as part of the engagement team (AS 1201).	Provides input on technical matters, such as fair value calculations, environmental liabilities, or legal matters. Operates as an advisor and does not issue an audit opinion.
Examples	Auditing a foreign subsidiary in a multinational group audit.	Another CPA firm audits a subsidiary's financial statements, and the group auditor makes reference to that report.	A network firm performing procedures at an issuer's foreign location for the lead auditor.	Actuary estimating pension liabilities or appraiser valuing real estate.
Purpose of Use	To integrate audit work into the group audit opinion.	To divide responsibility by making reference to another auditor's report.	To supply audit evidence supporting the lead auditor's opinion.	To provide expertise in technical or complex areas beyond the auditor’s knowledge.
Common Relevant Engagements	Audits (Group Audits, Integrated Audits), Governmental Audits.	Audits (when external auditors contribute work), Governmental Audits.	PCAOB audits (issuers and broker-dealers), including integrated audits.	Audits, Integrated Audits, SSAE Engagements (e.g., valuation, IT controls, legal matters).

Types of auditors in engagements (continued)

Key Differences

Referred-to Auditor vs. Component Auditor:

Component auditors are explicitly part of a group audit engagement under the direction of the group engagement team.

Referred-to auditors audit a component's financial statements and issue their own report; the group auditor makes reference to that report and does not take responsibility for their work.

Referred-to Auditor vs. Other Auditors:

Referred-to auditors are referenced and may be named in the audit report.

Other auditors work under the lead auditor's supervision and review; the lead auditor takes responsibility for their work.

Component Auditor vs. Specialist:

Component auditors perform actual audit work contributing to the financial statements.

Specialists provide expertise in areas requiring technical knowledge, supplementing the audit work but not forming opinions directly.

Component performance materiality is set lower than group performance materiality to address aggregation risk.

Types of auditors in engagements (continued)

Service Auditor vs. User Auditor

1 **Primary Role**:

- **Service Auditor**: Examines the controls of a service organization and issues a SOC 1 or SOC 2 report.
- **User Auditor**: Audits the financial statements of a user entity and evaluates the relevance of the service auditor’s report.

2 **Scope of Work**:

- **Service Auditor**: Focuses on internal controls at the service organization that impact user entities.
- **User Auditor**: Uses the service auditor's SOC 1 report (a type 2 report gives evidence that controls operated effectively) to assess risks and adjust the audit scope.

Types of auditors in engagements (continued)

3 **Inclusion in Reports**:

- **Service Auditor**: Issues a separate SOC report, typically not mentioned in the user auditor’s audit report.
- **User Auditor**: Uses the service auditor's report as audit evidence but does not refer to it in an unmodified opinion; a reference that explains a modified opinion must state that it does not reduce the user auditor's responsibility.

Audit risk formula diagram

AR = DR × CR × IR

Can be rewritten as
DR = AR ÷ (CR × IR)

RMM = IR × CR

Order to perform assessments		Step 1	Step 2	Step 3
	AR =	**IR ×**	**CR ×**	**DR**
		Assess inherent risk; it exists independently of the audit	Tests of controls (if relying on controls or substantive tests alone are insufficient; otherwise CR at maximum)	Substantive procedures: tests of details and substantive analytical procedures
Example numbers	**5% =**	**50% ×**	**50% ×**	**20%**
Example activities		**Complex business model**	**Testing internal controls to see if someone can steal cash**	**Testing to see if the cash balance is accurate**

Audit risk formula components

(AR) Audit Risk - The risk that the auditor expresses an inappropriate opinion when the financial statements are materially misstated.

(DR) Detection Risk

Related procedures: tests of details and substantive analytical procedures. The risk that the auditor will miss something/not detect it during the audit. Only one that the auditor can control. Can lower it by changing the nature, timing and extent of substantive procedures.

(CR) Control Risk

Control Risk is the risk that a material misstatement will not be prevented, or detected and corrected on a timely basis, by the entity's internal control.

Audit risk formula components (continued)

(IR) Inherent Risk

The susceptibility of an assertion to a material misstatement before considering controls. Inherent risk factors: complexity, subjectivity, change, uncertainty, and susceptibility to management bias or fraud (e.g., complex transactions, new financial reporting guidance, obsolete inventory).

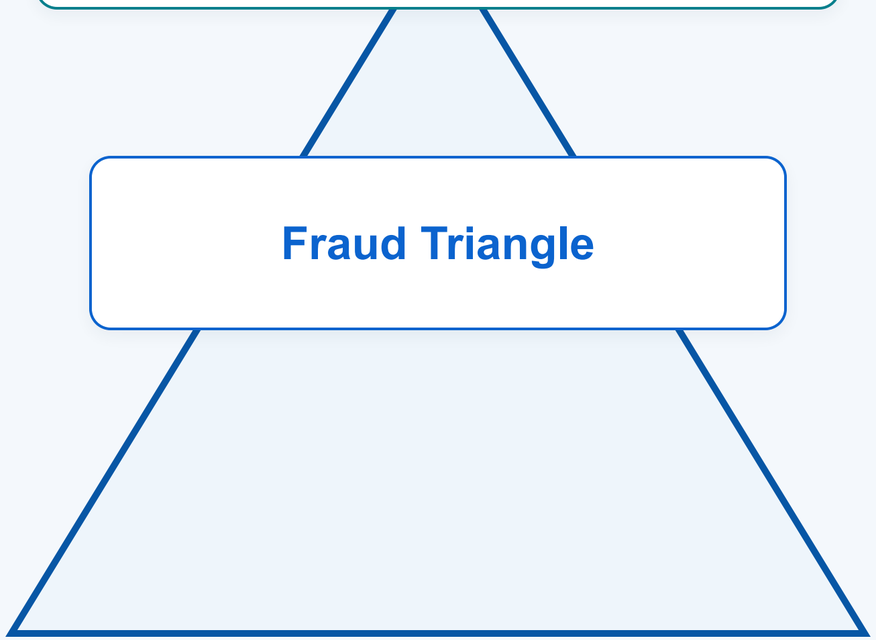
(RMM) Risk of Material Misstatement

The risk that the financial statements are materially misstated before the audit; at the assertion level it consists of inherent risk and control risk, which are assessed separately.

Fraud triangle

Opportunity

- Weak internal controls
- Ineffective monitoring of controls
- Assets susceptible to fraud



Incentive

Financial pressure:

- Greed
- Addictions
- Poor credit rating or cash management

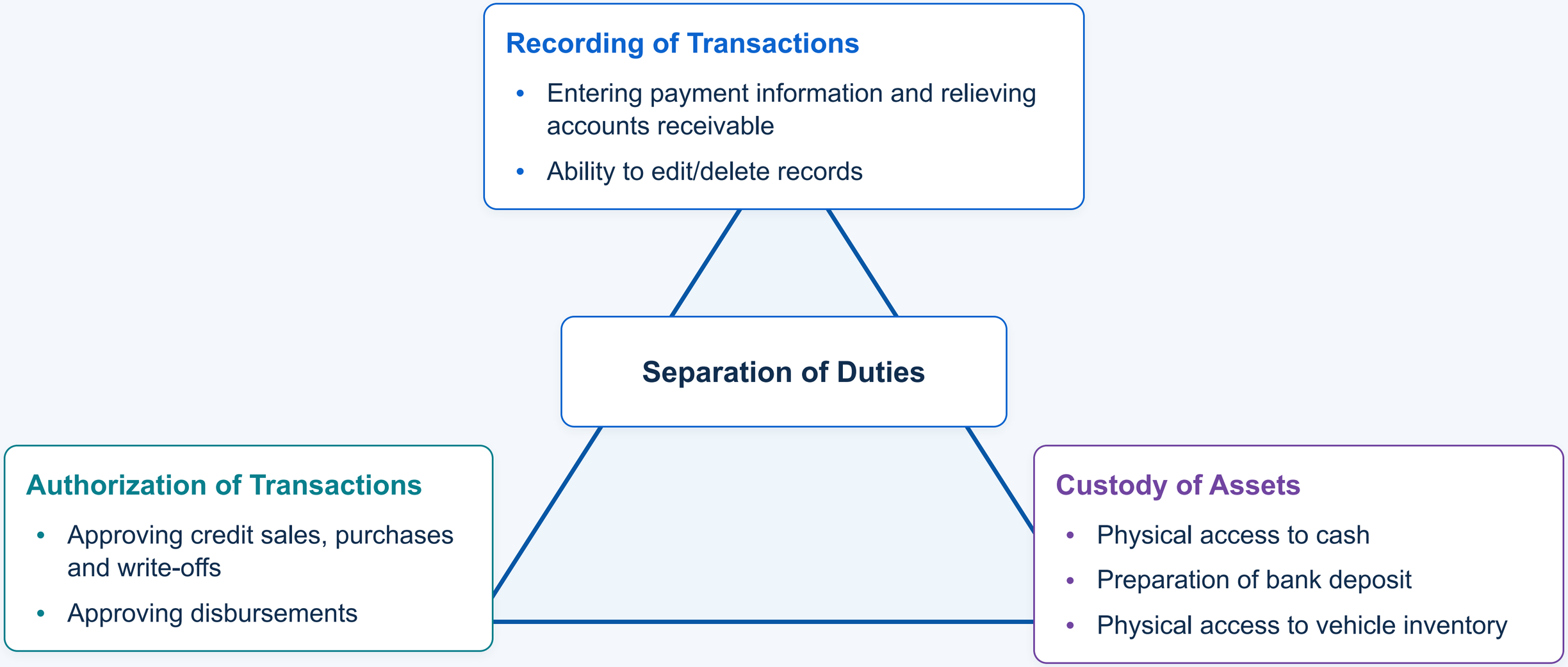
Work pressure:

- Dissatisfaction with pay
- Overlooked for promotion

Rationalization

- “I’ll pay it back.”
- “I deserve a pay raise.”
- “It’s for a good purpose.”

Separation of duties



Separation of duties (continued)

Ideally, personnel should not have more than one of these activities within their role. The risk/reward tradeoff is difficult at a smaller company which may need one employee to cover responsibilities in two of these areas.

Collusion and/or management override are the most common ways to circumvent separation of duties. Additional controls need to be put in place to contain these concerns.

Reconciliations and independent checks are done by someone with no custody or recording duties.

Types of internal controls

Internal Controls Classification

Preventive: Prevent errors and fraud before they occur.	Detective: Uncover errors and fraud after they have occurred.	Corrective: Correct the negative effects of unwanted events.
For example: • Segregation of duties • Job rotation (also detective) • Training • Dual access • Authorization and approval • Preformatted input	For example: • Transmittal documents • Batch control totals • Hash totals • Batch balancing • Check digits • Limit checks, validity checks (Input edit checks are preventive when they reject data at entry.)	For example: • Upstream resubmissions • Repairing damage • Remanufacturing • Isolating and removing viruses • Disciplinary action

Required communications to governance

Required Communications to Governance

Auditor’s Responsibility

- Expressing opinion.
- Consider internal control to design audit procedures, not to opine on its effectiveness.
- Audit doesn’t relieve management of their responsibility.

Additional Requirements for Issuers

- All critical accounting policies.
- Material alternative GAAP accounting treatments.
- Other material written communications with management.
- Corrected misstatements (not clearly trivial) found only by the audit; their financial reporting implications.
- Discuss and provide draft of auditor report.

Required communications to governance (continued)

Planned Scope and Timing

- Significant risks and how they will be addressed.
- Planned approach towards internal control.
- Materiality factors.
- Use of internal audit staff.
- Discuss TCWG’s attitudes toward and awareness of internal control.

Significant Deficiencies & Material Weaknesses

- In writing within 60 days of report release date (nonissuers); before the auditor's report is issued (issuers).
- Previously communicated items not yet corrected: communicate them again.
- To management (required): other deficiencies that merit management's attention.
- Auditor may not report lack of significant deficiency, but can report lack of material weakness.

Required communications to governance (continued)

Significant Audit Findings

- Views on qualitative aspects of accounting policies.
- Significant difficulties; disagreements with management.
- Uncorrected, non-trivial misstatements.
- Material corrected misstatements.
- Management representations.
- Management consultations with other accountants.
- Significant issues discussed with management; significant unusual transactions; circumstances affecting the form and content of the auditor's report.

Reliability of evidence

General guides only: evidence obtained directly by the auditor, external evidence and documentary evidence may be more reliable, but reliability depends on the source and circumstances.
SAS 142: evaluate information used as evidence for relevance and reliability, including accuracy, completeness, authenticity and susceptibility to management bias.

Reliability	Type	Example
High	Physical	Inventory Observation
↑	Documentary	
	External	Cutoff Bank Statement
	External/Internal	Purchase Invoice
↓	Internal	Sales Invoice
Low	Client Representations	Management Representation Letter
		Oral Representation

Types of evidence

A remittance advice is a notice sent to a supplier of goods or services to inform them of the payment that has been made. The notice includes the amount of the payment, the date of the payment, and the method of payment. The remittance advice can be used in auditing to verify that payments have been made as agreed.

A shipping document is a business record that is used to track the movement of goods and shipments. It can be used to verify the accuracy of invoices, to track inventory, and to monitor the progress of shipments.

A bank statement is a summary of all transactions that have occurred over a set period of time on a bank account. Bank statements are used in auditing to provide evidence of the financial activity of a company.

A receiving report is used in auditing to document and track the receipt of goods and services. The report typically includes the date of receipt, the name of the supplier, a description of the goods or services received, and the quantity received. The receiving report is used to reconcile the supplier invoices with the goods or services received.

Types of evidence (continued)

A bill of lading is a document used in auditing to verify the accuracy of a shipment of goods. The bill of lading lists the quantity and type of goods being shipped, the origin and destination of the shipment, and the date of the shipment. In auditing, it is evidence that goods were shipped (for example, sales cutoff and occurrence). The receiving department's authority to accept incoming goods is a copy of the approved purchase order.

A purchase order is a document used by an organization to request goods or services from another organization. It is typically used in the auditing process to ensure that all purchases made by the organization are properly documented and authorized.

A vendor invoice is used in auditing to support the occurrence of a vendor transaction. The invoice should include the vendor's name, address, and contact information, as well as the date, invoice number, and a description of the goods or services purchased.

A packing slip is a document that is usually sent with shipped goods that details the contents of the shipment. In auditing, the packing slip can be used to verify the accuracy of the goods that were shipped.

Types of client accounting records

A trial balance is a list of all the accounts for a business and their balances at a specific point in time. This is used in auditing to help verify the accuracy of the financial statements.

A bank reconciliation is used in auditing to reconcile the ending cash balance per the company's books with the ending cash balance per the bank statement.

The cash receipts and disbursement journal is used to audit an organization's cash receipts and disbursements. The journal can be used to track cash inflows and outflows, and compared with bank records to find any discrepancies. It ties in well with the bank reconciliation to display the annual activity between the beginning and ending cash balances.

There are a number of different payroll records that may be used in auditing, including time cards, payroll registers, and payroll journals. These records can be used to help verify the accuracy of employee wages and hours worked.

An accounts receivable aging schedule is used in auditing to track the amount of time that invoices have been outstanding. This information is used to assess the risk of nonpayment and to determine whether the company has adequate provisions for bad debts.

Types of client accounting records (continued)

A fixed asset rollforward is used in auditing to help verify the existence and accuracy of a company's fixed assets. The rollforward lists all of the company's fixed assets as of the beginning of the year, and then tracks any changes to those assets throughout the year. This information can be used to verify that the company's depreciation expense is accurate and that its balance sheet correctly reflects the carrying amount of its fixed assets.

The debt rollforward is used in auditing to show how the balance of a company's debt has changed over time. This information can be used to assess the financial health of the company and to identify any potential red flags.

Example trial balance; general ledger (separate illustration)

Gold Guitars, Inc.
Unadjusted Trial Balance
December 31, Year 5

Acct No.	Account	Debit	Credit
100	Cash	100.00	
110	Accounts Receivable	500.00	
150	Fixed Assets	3,000.00	
175	Deposits	50.00	
200	Accounts Payable		50.00
210	Credit Cards Payable		250.00
250	Long Term Debt		2,500.00
300	Retained Earnings		100.00
600	Revenue		900.00
700	Depreciation	15.00	
705	Salaries Expense	100.00	
710	Operating Expense	35.00	
	Totals	3,800.00	3,800.00

Example trial balance; general ledger (separate illustration) (continued)

GL Account	Transaction Number	Date	Description	Debit	Credit
1010-01	53765	4/4/2022	Cash receipt	$4,088.88	$0.00
1010-01	53766	4/4/2022	Cash receipt	$1,330.06	$0.00
1010-01	53767	4/4/2022	Cash receipt	$178.20	$0.00
1010-01	53768	4/4/2022	Cash receipt	$9,334.12	$0.00
1010-01	53769	4/4/2022	Purchase	$0.00	$2,592.59
1010-01	53770	4/4/2022	Cash receipt	$8,325.10	$0.00
1010-01	53771	4/4/2022	Cash receipt	$5,636.80	$0.00
1010-01	53772	4/4/2022	Purchase	$0.00	$9,334.12
1020-01	53773	4/5/2022	Payroll Outflow	$0.00	$732.52
1020-01	53774	4/5/2022	Interest Inflow	$4,540.60	$0.00
1020-01	53775	4/5/2022	Interest Inflow	$2,083.20	$0.00

Example trial balance; general ledger (separate illustration) (continued)

GL Account	Transaction Number	Date	Description	Debit	Credit
1020-01	53776	4/5/2022	Interest Inflow	$8,005.80	$0.00
1020-01	53777	4/5/2022	Interest Inflow	$2,183.40	$0.00
1020-01	53778	4/5/2022	Interest Inflow	$1,204.20	$0.00
1020-01	53779	4/5/2022	Interest Inflow	$10,917.00	$0.00
1020-01	53780	4/5/2022	Interest Inflow	$4,677.20	$0.00
1020-02	53781	4/5/2022	Interest Inflow	$10,607.30	$0.00
1020-02	53782	4/5/2022	Interest Inflow	$5,420.00	$0.00
1020-02	53783	4/5/2022	Interest Inflow	$1,823.50	$0.00
1020-02	53784	4/5/2022	Interest Inflow	$383.50	$0.00
1020-02	53785	4/5/2022	Interest Inflow	$4,934.88	$0.00
1020-02	53786	4/5/2022	Interest Inflow	$4,523.64	$0.00

Sampling terms

Actual Sampling Results: This refers to the results obtained from the sample of an audit population.

Actual Population Results: This refers to the results obtained from the entire population being audited.

Expected Deviation (Expectations): The auditor's estimate of the rate of deviation from the control in the population (from prior years or a pilot sample); a higher expected rate means a larger sample.

Tolerable Rate (Maximum accepted): The rate of deviation the auditor sets, seeking appropriate assurance that the actual rate of deviation in the population does not exceed it.

Projected misstatement is the auditor's best estimate of misstatement in the population, projected from the misstatement found in the sample. Projected misstatement = (sample misstatement ÷ sample value) × population value, or (sample misstatement ÷ number of sample items) × number of population items.

Sampling terms (continued)

Reliability (confidence level) is the complement of sampling risk (for example, 95% reliability = 5% risk of assessing control risk too low). In audit sampling, select items so that each sampling unit has a chance of selection, so the sample is representative of the population.

Precision (allowance for sampling risk) is the range around the sample result within which the population value is expected to fall at that confidence level.

Standard deviation is a measure of the spread of a population's values around its mean. It is useful for understanding the variability of a population and can be used to determine the sample size needed for a given level of accuracy. In audit sampling, it is important to ensure that the sample size is sufficient to provide accurate results.

- Attribute sampling (tests of controls) estimates deviation rates; variables or monetary-unit sampling (tests of details) estimates dollar misstatement. Assessing control risk too low and incorrect acceptance hurt effectiveness; assessing control risk too high and incorrect rejection hurt efficiency.

Nonstatistical vs statistical sampling

Nonstatistical sampling still permits the auditor to draw conclusions about the population, but sampling risk is judged qualitatively rather than measured statistically. This type of sampling relies on the auditor's professional judgment to select a sample that is representative of the population. It can be used for any population size. Its main disadvantage is that sampling risk cannot be quantified.

Statistical sampling uses random selection and a statistical technique to evaluate the results, including measuring sampling risk. Both approaches can be used for large or small populations and both support conclusions about the population. The main disadvantage of statistical sampling is that it can be time-consuming and expensive.

In both nonstatistical and statistical sampling, the sample size is determined based on the sampling risk that the auditor is willing to accept based on their professional judgment.

Sample size also depends on the tolerable and expected deviation (or misstatement) and the population's characteristics.

Determining allowance for sampling risk with an example

The allowance for sampling risk is the difference between the upper deviation rate and the sample deviation rate; it reflects the uncertainty in projecting the sample result to the population. The maximum acceptable rate is the tolerable rate: if the upper deviation rate exceeds the tolerable rate, the auditor cannot rely on the control as planned.

Allowance for Sampling Risk = Upper Deviation Rate - Sample Deviation Rate (Percentage of Problems with the Sample)

An auditor wanted to validate the authorization for 15,000 sales invoices processed during the year. An analysis of a sample of 300 invoices was done and it was found that 15 of them lacked approval. To reach a 90% confidence level, the auditor set up a statistical sample which had a 10% risk of assessing control risk too low. Based on previous experience, the auditor estimated that 4% of the sales invoices may have lacked approval. The upper deviation rate was then found to be 7%.

The allowance for sampling risk is the excess of the 7% upper deviation rate over the 5% sample deviation rate (calculated from 15 / 300). 7% - 5% = **2%**.

Sampling factors and their effects

Conditions leading to			
Factor	**Smaller sample size**	**Larger sample size**	**Related factor for substantive sample planning**
a. Assessment of inherent risk.	Low assessed level of inherent risk.	High assessed level of inherent risk.	Allowable risk of incorrect acceptance.
b. Assessment of control risk.	Low assessed level of control risk.	High assessed level of control risk.	Allowable risk of incorrect acceptance.
c. Assessment of risk for other substantive procedures related to the same assertion (including substantive analytical procedures and other relevant substantive procedures).	Low assessment of risk associated with other relevant substantive procedures.	High assessment of risk associated with other relevant substantive procedures.	Allowable risk of incorrect acceptance
d. Measure of tolerable misstatement for a specific account.	Larger measure of tolerable misstatement.	Smaller measure of tolerable misstatement.	Tolerable misstatement.
e. Expected size and frequency of misstatements.	Smaller misstatements or lower frequency.	Larger misstatements or higher frequency.	Assessment of population characteristics.
f. Number of items in the population.	Virtually no effect on sample size unless population is very small.		
g. Choice between statistical and nonstatistical sampling	Ordinarily, sample sizes are comparable.		

Significant deficiencies & material weaknesses

Material Weakness	A deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.
Significant Deficiency	A deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Miscellaneous internal control items

Objectives of Internal Control

- Reporting (financial and nonfinancial, internal and external)
- Effectiveness and Efficiency of operations
- Compliance with applicable laws & regulations

Critical Controls

Prenumbered documents
Authorization
Independent checks
Documentation
Timely and appropriate financial performance reviews
Information-processing controls
Physical Controls
Segregation of duties

Auditor's Responsibility / Understand:

- Evaluate design of controls
- Have they been implemented
- Assess risk
- Design procedures based on risk

Walk through

- Inquiry
- Observation
- Inspection of documents
- Reperformance

Document Internal Controls

- Narrative
- Questionnaire
- Flowchart
- Procedure manuals and org. charts

A (continued)

Miscellaneous internal control items (continued)

A (continued)

CRIME	
Control Activities	Authorization of transactions Segregation of duties Prenumbered documents Performance reviews
Risk Assessment	Adoption of a new accounting policy New personnel New technology Corporate restructuring
Information & Communication	Proper presentation of transactions and related disclosures Measurement and recording of proper monetary values How significant events are captured in accounting system
Monitoring	Internal Audit function
Environment	Participation of those charged with governance Assignment of authority, responsibility, and accountability Human resources policies and procedures

Miscellaneous internal control items (continued)

- Information technology (IT) controls (SAS 145): identify the IT applications subject to risks arising from IT and the general IT controls that address them (access, program changes, IT operations). Evaluate their design and implementation; that does not test operating effectiveness.

Conducting analytical procedures

Analytical procedures usually compare current year balances to prior year ones or external balances such as those of a competitor or the industry average. Analytical procedures performed as risk assessment procedures usually use financial and nonfinancial data aggregated at a high level; substantive analytical procedures need more precise, often disaggregated, data.

The first step for performing analytical procedures would be to develop an expectation of a balance or ratio by using relationships that are expected to exist. Analytical procedures are required during the planning stage and during the final review stage of an engagement.

Examples of analytical procedures:

- Converting dollar amounts of income statement account balances to percentages of net sales for comparison with industry averages.
- Developing the current year's expected net sales based on the sales trend of similar entities within the same industry.
- Estimating the current year's expected expenses based on the prior year's expenses and the current year's budget.
- Comparing current-year to prior-year sales volumes.
- Multiplying the average outstanding loan balance by the interest rate and comparing the result to interest expense actually recorded.
- Comparing inventory balances to recent sales activities.

Conducting analytical procedures (continued)

- Substantive analytical procedures: confirm suitability for the assertion, check the data's reliability, develop a precise expectation, set the acceptable difference, and investigate significant differences (inquiry plus corroborating evidence).

Analytical procedure example

ABC Company Balance Sheet

Year 2 Audit

Supreme CPA Firm, Analytical Procedures

	Year 1	Year 2	
Assets			
Cash	$1,000	$1,500	50%
A/R	$5,000	$4,500	-10%
Inventory	$10,000	$12,500	25%
Liabilities			
A/P	$3,000	$6,500	116.7% ✓
Long-term Debt	$5,000	$2,000	-60% ✓
Equity			
Common Stock	$4,000	$4,000	0%
Retained Earnings	$4,000	$6,000	50%

Expectation: balances near Year 1 (% = change from Year 1). Threshold: changes over 50% (up or down) are significant variances to investigate.

Liquidity ratios

Liquidity

Analytic	Formula	Reference
Current Ratio	Current Assets / Current Liabilities	BS
Quick Ratio	(Cash & Cash Equivalents + Marketable securities + Receivables (net)) ÷ Current Liabilities	BS BS
Working Capital	Current Assets - Current Liabilities	BS - BS

Activity ratios

Activity

Analytic	Formula	Reference
Accounts Receivable Turnover	Sales (net) ÷ Average Accounts Receivable (net)	IS Avg. BS
Days Sales in Accounts Receivable	Ending Accounts Receivable (net) ÷ (Sales (net) / 365)	BS IS/365
Inventory Turnover	Cost of Goods Sold ÷ Average Inventory	IS Avg. BS
Days in Inventory	Ending Inventory ÷ (Cost of Goods Sold / 365)	BS IS/365
Operating Cycle	Days Sales in Accounts Receivable + Days in Inventory	AR + Inv
Working Capital Turnover	Sales (net) ÷ Average Working Capital	IS Avg. BS
Asset Turnover	Sales (net) ÷ Average Total Assets	IS Avg. BS
Accounts Payable Turnover	Cost of Goods Sold ÷ Average Accounts Payable	IS Avg. BS
Days of Payables Outstanding	Ending Accounts Payable ÷ (Cost of Goods Sold / 365)	BS IS/365
Cash Conversion Cycle	Days Sales in Accounts Receivable + Days in Inventory - Days of payables outstanding	AR + Inv - AP

Comparing company financial metrics

Ratio	ABC Company	Better or Worse	Industry
ROE	14.7%	**Worse**	16%
Current Ratio	3	**Better**	2.5
A/R Turnover	12.5	**Better**	10
Cash Conv. Cycle (days)	82.7	**Worse**	60
Growth Rate	3.07%	**Worse**	5%

For most ratios, we can compare the company against prior periods, budgets, or the industry to set expectations and spot unusual relationships to investigate. These are just some of the ratios calculated in this section. Make sure you know each ratio and if it is preferable or not to have a higher or lower one!

Summary of procedures

Auditing Procedures

Examining/Inspecting

Observation

- Watching a process or procedure being performed by others (e.g., the client's inventory count).

Inspection

- Examining records or documents (internal or external, paper or electronic) or physically examining an asset.

Verifying

Recalculation

- Checking the accuracy of math.

Reperformance

- Independently recreating a process.

Communication

Inquiry

- Seeking information from knowledgeable persons within or outside the entity.
- **Inquiry** alone is not sufficient (for example, to test the operating effectiveness of controls).

Confirmation

- A direct written response to the auditor from a third party (paper or electronic). Commonly used for existence of receivables and cash.

Analysis

Analytical (Procedure)

- Ratio analysis & searching for unusual balances/amounts/activity. Compares recorded amounts to auditor expectations.

Inquiry & inspection of records & confirmations - examples

The following are examples of how an auditor would conduct testing through inquiry and inspection:

- An auditor decides to test the controller's **review** of the bank reconciliation. The auditor interviews the controller in order to understand the specific data reviewed on the reconciliation. The auditor also verifies that the bank reconciliation is properly prepared by the staff accountant and reviewed by the controller as evidenced by their respective sign-offs.
- Determining whether the aging categories on the aged accounts payable trial balance are accurate.
- Obtaining a letter from the client's legal counsel to identify any outstanding material contingencies.
- Review the entity's bank statements and check that deposits listed on the bank statements are from the entity's customers.
- Review the entity's accounts receivable aging report and trace the balances to sales invoices and shipping documents.

The following are examples of how an auditor would conduct testing through confirmation:

- The auditor would send out letters to third parties such as customers to confirm A/R balances, vendors to confirm A/P balances, etc. and request information about the client that should match up with what the client has in its own records. The auditor would then review the responses to confirm the accuracy of the information provided by the client.
- Send confirmation requests for a sample of A/R balances directly to customers; the auditor controls the requests and customers reply directly to the auditor.
- Contact a sample of the entity's customers to confirm that they have done business with the entity and to inquire about the terms of the transactions.
- Confirm cash balances, loans and other arrangements directly with the entity's banks.
- Confirm goods held by a public warehouse or consignee directly with the custodian.

Observation, reperformance, & recalculation - examples

The following are examples of how an auditor would conduct testing through observation:

- Observe the client's personnel performing an internal control procedure.
- Observe the warehouse supervisor counting goods delivered before signing the delivery note from the supplier.
- Observing the interaction between employees and managers.
- Observing employees as they perform their job duties.
- Observing the use of equipment and resources.
- Observation is evidence only at the moment observed, and people may act differently when watched (AU-C 500.A54).

Observation, reperformance, & recalculation - examples (continued)

The following are examples of how an auditor would conduct testing through reperformance and recalculation:

Reperformance

- The auditor independently reperforms a control the entity performed, for example re-preparing the bank reconciliation and comparing it with the entity's version.

Recalculation

- Determining the mathematical accuracy of costs on an invoice sent to a customer.
- Testing the amount of FICA tax withheld from an employee’s paycheck.

Keep in mind that procedures such as recalculation are checking the mathematical accuracy of items to identify misstatements, both from error and fraud.

Testing the cash balance

The auditor's approach for combined testing of controls and details of cash is to first assess control risk and then to test both controls and details of cash. The auditor evaluates the design and implementation of relevant controls. Control risk can be assessed below maximum only if the auditor plans to test, and tests, operating effectiveness; otherwise control risk is assessed at maximum. The auditor would then test both controls and details of cash by performing procedures such as inspecting documentation, observing processes, and testing transactions.

Testing controls

- Completeness of cash receipts for cash sales.

- The auditor would observe the consistency of the employees' use of cash registers.

- Test the controls in place over the cash receipts and disbursements process.
- Test controls when you plan to rely on them or when substantive procedures alone cannot give enough evidence (AU-C 330.08).

Testing the cash balance (continued)

Testing the cash account balance (substantive procedures)

- Substantive analytical procedure: compare the cash balance and interest income with expectations.
- Test of details: review the bank statements and reconcile them to the cash balance per the books.

Issuer audits (Public Company Accounting Oversight Board AS 2310): for cash held by third parties, confirm with the bank or directly access the information from a knowledgeable external source; a client-provided statement is not enough.

Management assertions

Assertions about Classes of Transactions and Events (and Related Disclosures)

The following six assertions apply to transactions and events for the period under audit, and to their related disclosures:

- Occurrence. Recorded or disclosed transactions and events took place and pertain to the entity.
- Completeness. All transactions and events that should have been recorded have been recorded, and all related disclosures are included.
- Accuracy. Amounts and other data were recorded appropriately, and related disclosures are appropriately measured and described.
- Cutoff. Transactions and events were recorded in the correct accounting period.
- Classification. Transactions and events were recorded in the proper accounts.
- Presentation. Transactions and events are appropriately aggregated or disaggregated and clearly described, and related disclosures are relevant and understandable.

Assertions about Account Balances (and Related Disclosures)

The following six assertions apply to ending balances at the period end, and to their related disclosures:

- Existence. Assets, liabilities, and equity interests exist.
- Rights and obligations. The entity holds or controls the rights to its assets, and its liabilities are obligations of the entity.
- Completeness. All assets, liabilities, and equity interests that should have been recorded have been recorded, and all related disclosures are included.
- Accuracy, valuation, and allocation. Balances are included at appropriate amounts, any valuation or allocation adjustments are recorded, and related disclosures are appropriately measured and described.
- Classification. Assets, liabilities, and equity interests were recorded in the proper accounts.
- Presentation. Balances are appropriately aggregated or disaggregated and clearly described, and related disclosures are relevant and understandable.

Management assertions (continued)

- Current AU-C 315 groups assertions in two sets. Transactions and events (with related disclosures): occurrence, completeness, accuracy, cutoff, classification, presentation. Account balances (with related disclosures): existence; rights and obligations; completeness; accuracy, valuation, and allocation; classification; presentation. Presentation: items are properly aggregated or disaggregated, clearly described, and disclosures are relevant and understandable. Public Company Accounting Oversight Board (AS 1105): existence or occurrence; completeness; valuation or allocation; rights and obligations; presentation and disclosure.

Statements included in the management representation letter

Management's representation & responsibility for disclosing related parties, going concern, litigation, estimates, & more

Includes statements:

- That the financial statements are management’s responsibility.
- That information is complete.
- That all transactions have been recorded and are reflected in the financial statements.
- That fraud known to management is disclosed.
- That management believes the effects of uncorrected misstatements are immaterial, individually and in the aggregate, with a summary of them included in or attached to the letter.
- On responsibility for internal control to prevent and detect fraud.
- On fraud risk assessment results.

Statements included in the management representation letter (continued)

- Covering all periods reported on by the auditor.
- On knowledge of laws & regulations.
- On knowledge of noncompliance.
- That the methods, significant assumptions and data used in accounting estimates, and the related disclosures, are appropriate under the applicable financial reporting framework.
- Disclosing knowledge of fraud or suspected fraud involving management, employees with significant roles in internal control, or others where the fraud could have a material effect; and any fraud allegations communicated by employees, former employees, regulators or others.

- That all of the following have been accounted for and disclosed:

  - Litigation & claims.
  - Compensating balances and other restrictions on cash.
  - Related parties and related party relationships and transactions known to management.
  - Subsequent events.

Management's representation & responsibility for disclosing related parties, going concern, litigation, estimates, & more

- Addressed to the auditor, usually signed by the chief executive officer and chief financial officer, dated as of the auditor's report date, and covering all periods in the report. If management will not provide the representations about its responsibilities, the auditor disclaims an opinion or withdraws. Representations support, never replace, other evidence.

Relevant assertions in auditing

Is everything properly included where it should be?

Completeness
All transactions and events that should have been recorded have been recorded. An audit test for this regarding completeness of sales would be to sample shipments during the year and trace each source document to the books via the sales journal.
Cutoff
Determine whether the transactions recorded have been recorded in the appropriate accounting period.

Transactions (mainly revenues and assets) actually exist and have occurred.

Existence
Test of Details. Assets, liabilities and equity interests exist. Physically inspect tangible assets; use confirmation and documents for receivables, liabilities and equity.
Occurrence
Test of Details. Vouch entries from the voucher register to the supporting source documents to test that recorded purchases occurred.

Does the entity hold or control rights to the assets listed, and are the liabilities listed its obligations?

Rights
Does the entity have the rights to all assets listed on the balance sheet?
Obligations
Are the liabilities listed on the balance sheet obligations of the entity?

Relevant assertions in auditing (continued)

Are the amounts correct?

Valuation

Was this the proper method/correct amount with regard to GAAP? Writing up land to current market value is clearly not proper GAAP. Assets, liabilities, and equity interests are included in the financial statements at appropriate amounts (relative to the requirements of GAAP) and any resulting valuation or allocation adjustments are appropriately recorded.

Allocation

Includes matters such as the inclusion of appropriate overhead amounts into inventory valuation.

Accuracy

Amounts and other data are recorded appropriately. Example: the correct GAAP method was used, but a computation or posting error produced a wrong amount.

Are the financial statement items classified and presented in a useful way for the users?

Classification & Presentation

Information included in the financial statements has been appropriately presented and is clearly understandable.

Classification

Current vs noncurrent balance sheet classification.

Relevant assertion: an assertion with an identified risk of material misstatement.

Tracing & vouching

Difference between tracing and vouching in audit	
Tracing	**Vouching**
Start from source documents to accounting records.	Start from accounting records to source documents.
To ensure the transactions or balances that should have been recorded have actually been recorded.	To ensure the transactions or balances that have been recorded are adequately supported.
To test the completeness assertion.	To test the occurrence or existence assertion.
To detect the risk of an understatement.	To detect the risk of an overstatement.

Revenue cycle

Revenue Cycle

Component	Accounts Receivable	Sales	Sales & Accounts Receivable
Related Assertion	**Account Balance**	**Transactions**	**Related Disclosures**
Completeness	• Perform analytical procedures (e.g., compare AR and sales with expectations).	• Trace sample of shipping documents to sales invoices and sales journals to accounts receivable sub ledger.	• Ensure required disclosures are included.
Cutoff		• Compare sales invoices before and after year end with dates recorded in sales journal. Analyze sales returns after year end.	
Valuation, Allocation & Accuracy	• Foot aged trial balance and agree to GL. • Test the allowance for credit losses as an estimate: test the aging, review subsequent cash receipts and credit information, and look for management bias. Confirmations support existence more than collectibility.	• Compare prices and terms on sales invoices with authorized price lists and terms of trade.	• Read footnotes.
Existence & Occurrence	• Confirm sample of accounts receivable.	• Vouch sales transactions from sales journal to sales invoices, customer order and shipping documents.	• Compare to audit evidence to determine occurrence.
Rights & Obligations	• Review bank confirmations and debt agreements for liens on receivables. Inquire of management and read board minutes.		• Determine if receivables are pledged, assigned, or discounted.
Classification & Presentation		• Examine sales invoice for proper classification of revenue accounts.	• Read required disclosures.

Positive & negative confirmations of accounts receivable

Advantages of Positive Confirmations:

- They provide more persuasive evidence than negatives, since a reply is expected, and can also confirm terms such as payment terms.
- They can be used to verify the accuracy of customer balances and identify any discrepancies.

Disadvantages of Positive Confirmations:

- The process of obtaining positive confirmations can be time consuming and costly.
- Customers may be reluctant to respond to the confirmation requests.

Advantages of Negative Confirmations:

- Negative confirmations are less intrusive than positive confirmations and can be less time consuming and less costly.
- Negative confirmations are easier to administer since follow-up on non-responses is not required.

Disadvantages of Negative Confirmations:

- Negative confirmations do not provide the same level of assurance as positive confirmations.
- They may not provide the same level of detail as positive confirmations.
- Nonissuers only (AU-C 505.15; never alone under PCAOB AS 2310): they can be the sole substantive procedure only with low risk and tested controls, many small homogeneous balances, very few expected exceptions, and attentive recipients.
- The auditor cannot infer that all nonrespondents have verified their account information.

Positive & negative confirmations of accounts receivable (continued)

- Positive requests ask for a reply either way; negative requests ask for a reply only if the recipient disagrees. Nonissuers: negatives may be the sole substantive procedure only if risk is low with tested effective controls, the population is many small homogeneous balances, a very low exception rate is expected, and recipients are not expected to ignore requests. Issuers: negatives alone are never sufficient. Nonissuers (AU-C 330.20): confirm accounts receivable unless it is immaterial, confirmation would be ineffective, or risk is low and other procedures address it.

- The auditor controls sending and receipt. For a positive request with no reply, perform alternative procedures (for accounts receivable: subsequent cash receipts, shipping documents). An oral reply is not a confirmation. When an electronic platform is used, assess its reliability.

Flowchart symbols



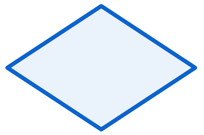
Process

Computer operation or task



Manual Process

Human / manual operation



Decision

Yes / No branching point



Document

Single document



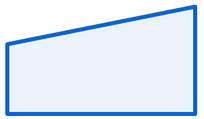
Multiple Documents

Multiple documents



Input / Output

Data entering or leaving system



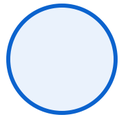
Manual Input

Keyboard / manual data entry



Start / End

Terminator: beginning or end



On-Page Connector

Links sections on same page



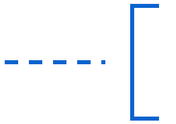
Off-Page Connector

Flow continues on another page



Flow Line

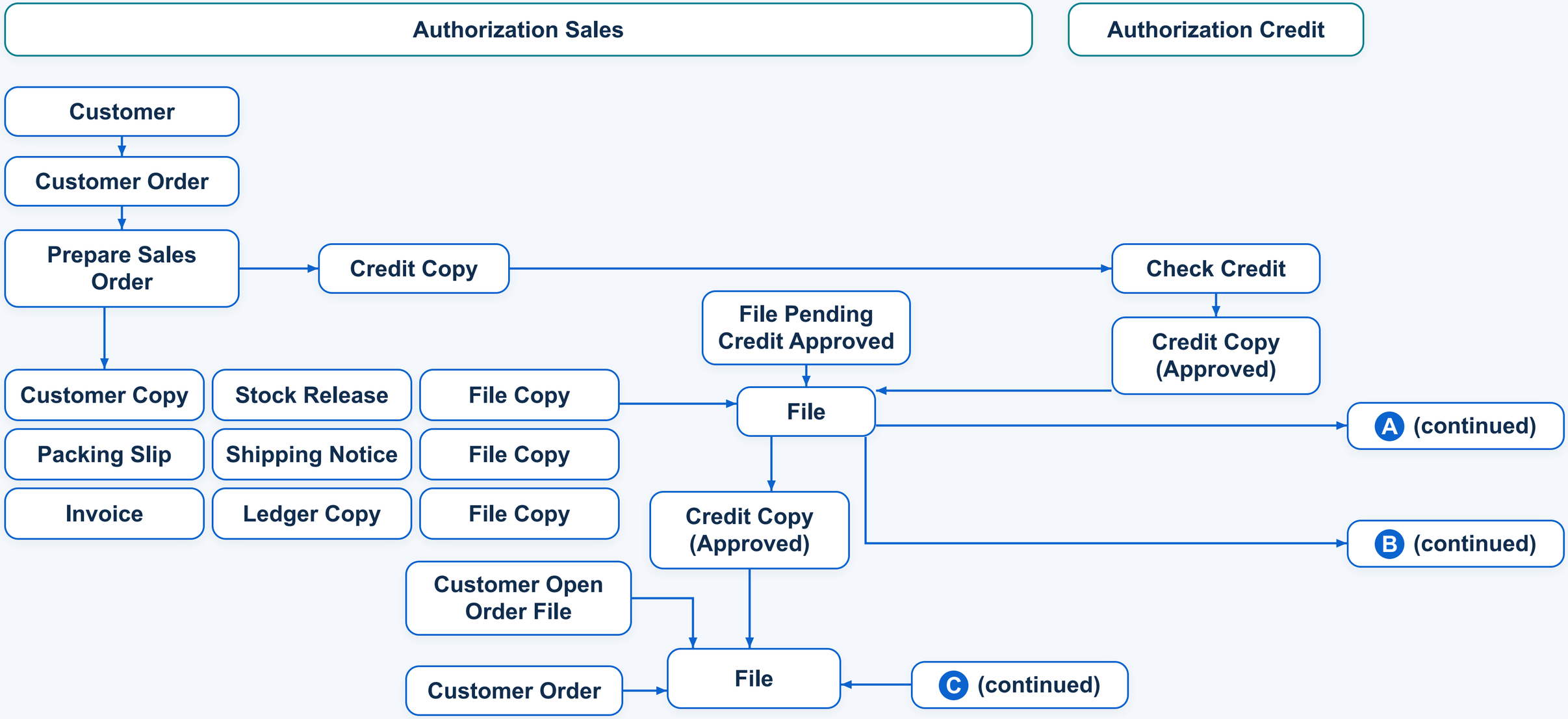
Direction of process flow



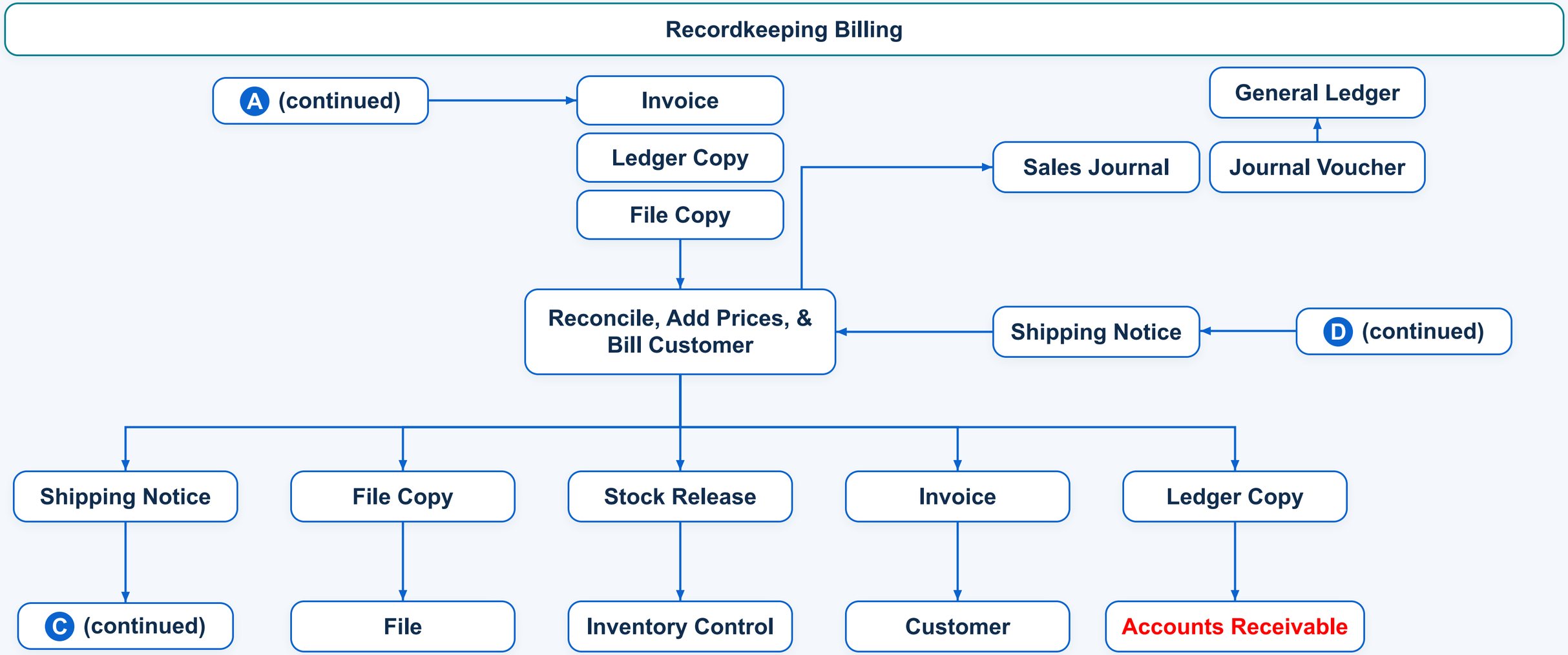
Annotation

Explanatory comment or note

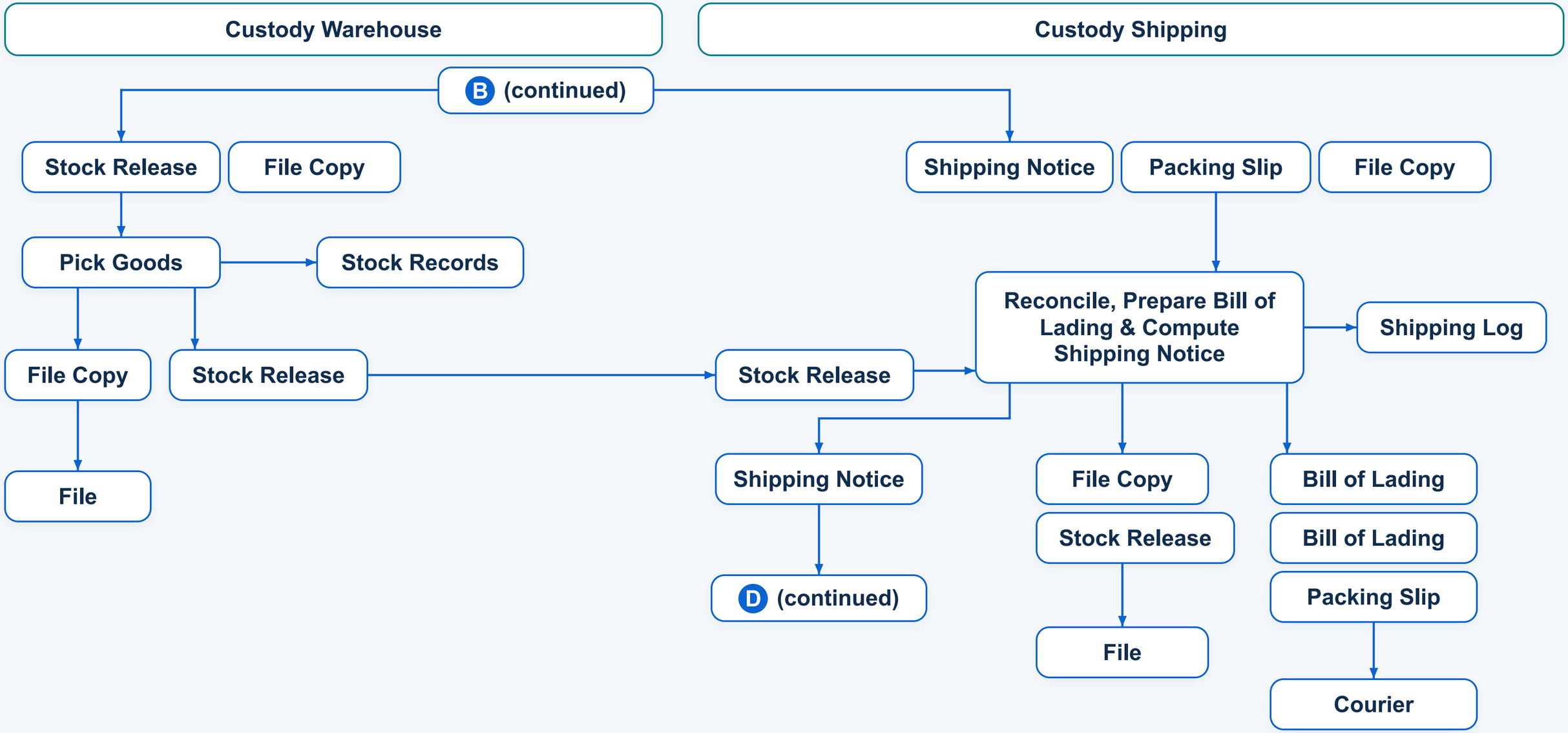
Revenue cycle



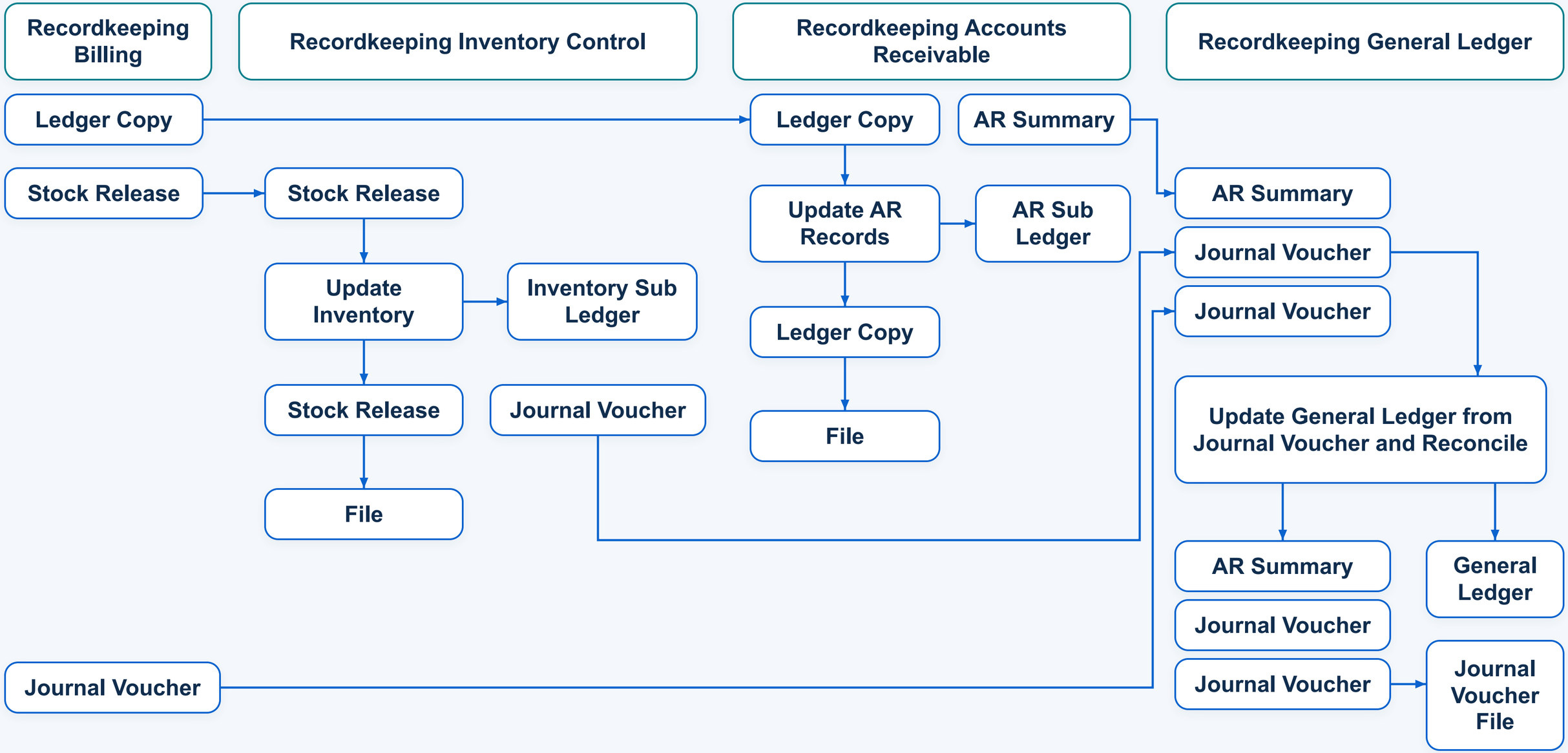
Revenue cycle (continued)



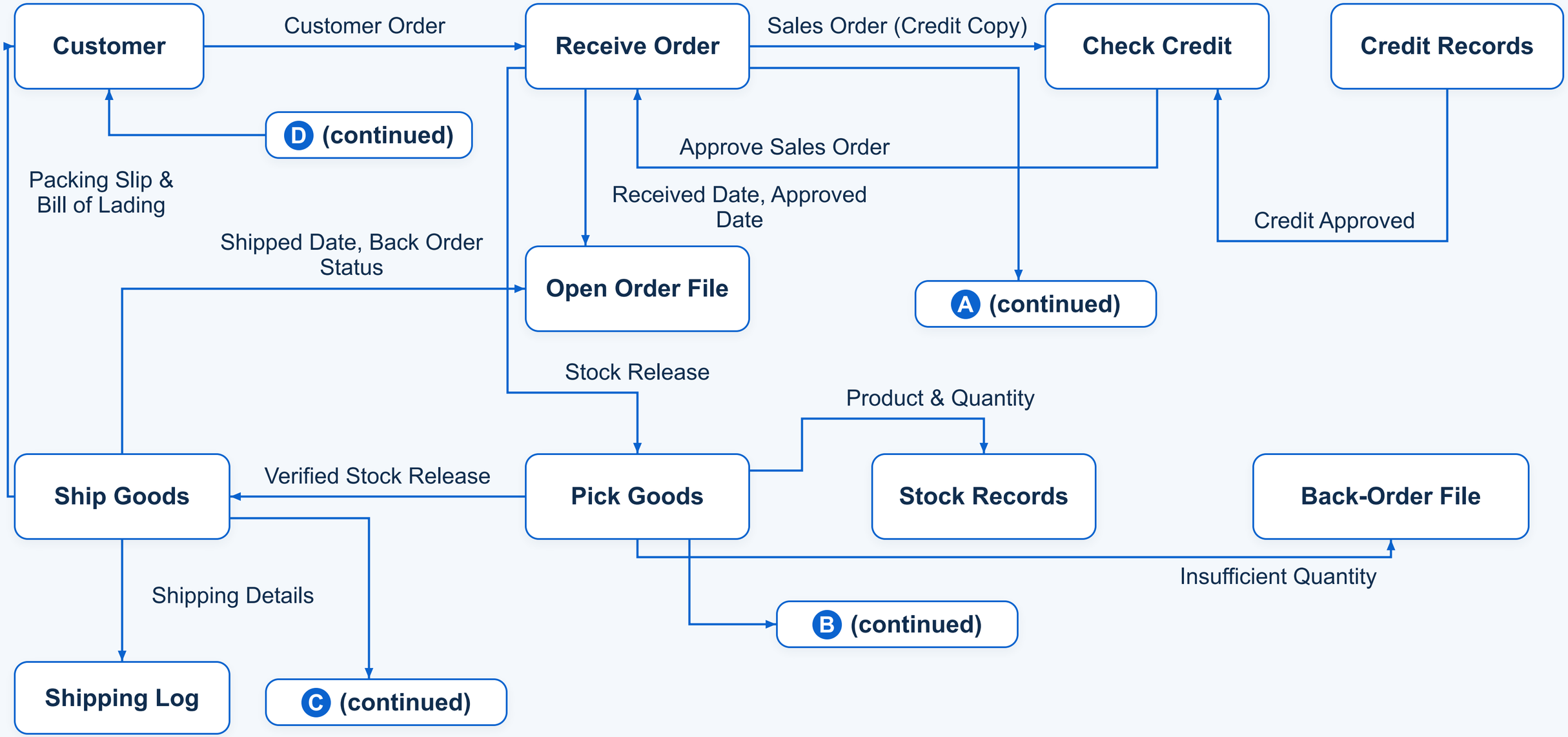
Revenue cycle (continued)



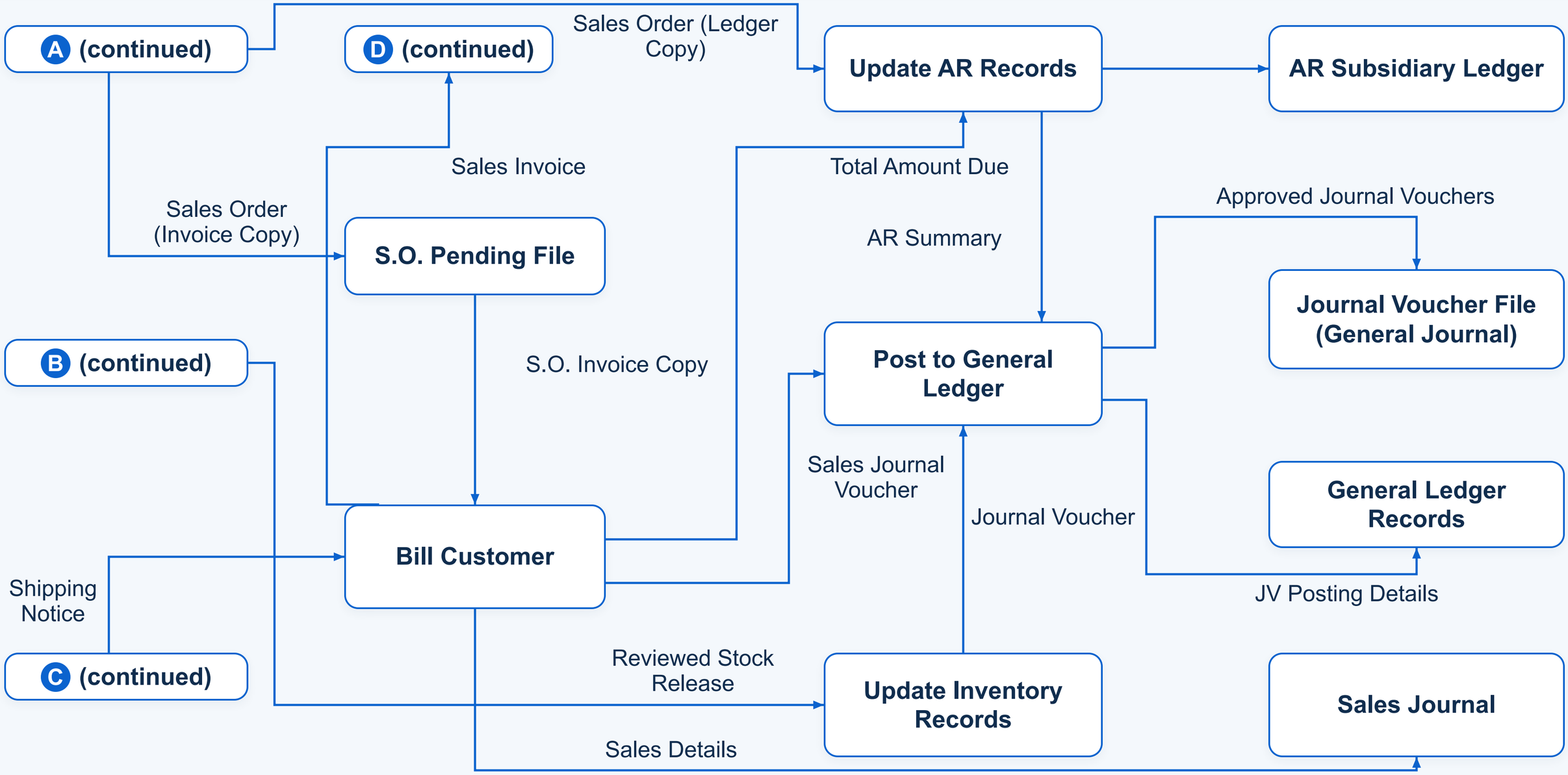
Revenue cycle - recordkeeping flowchart



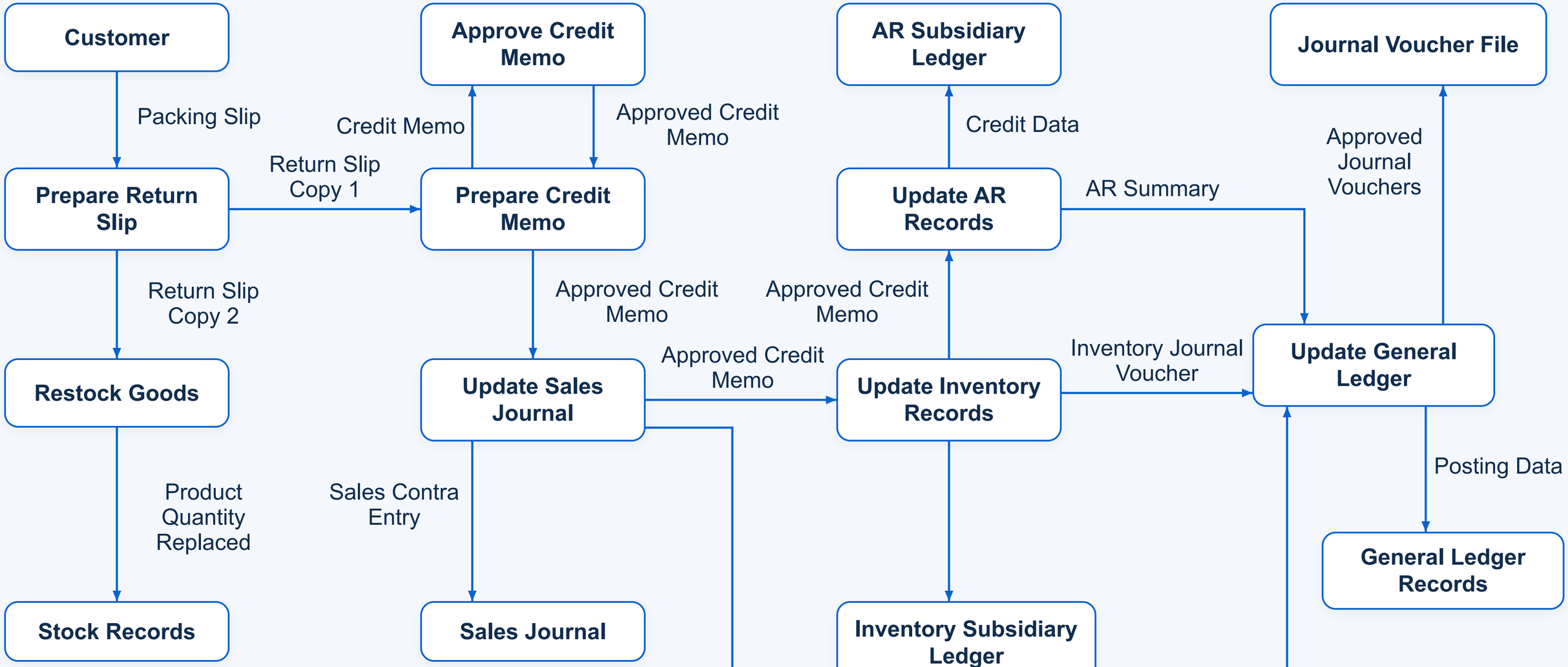
Sales order process data flow diagram



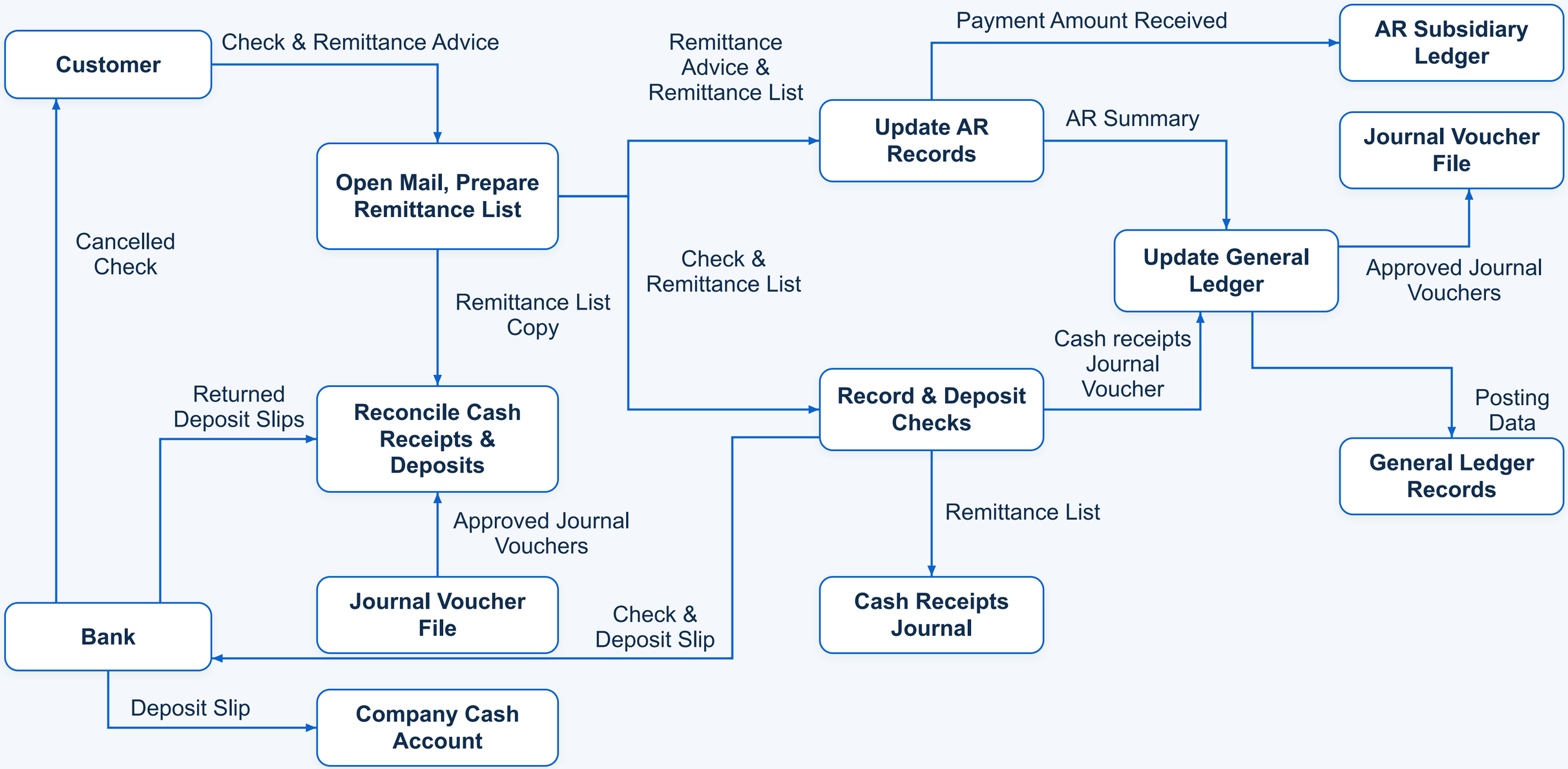
Sales order process data flow diagram (continued)



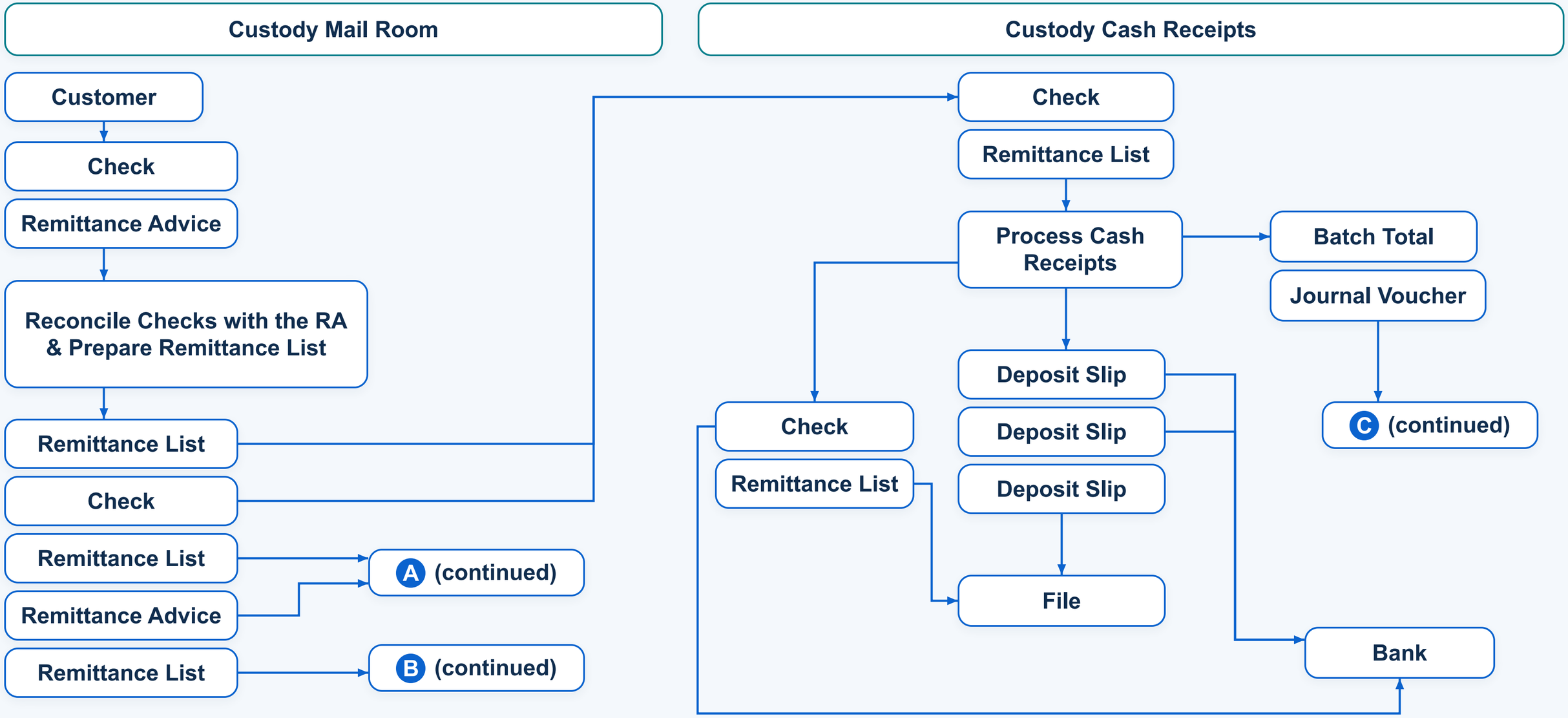
Sales returns flowchart



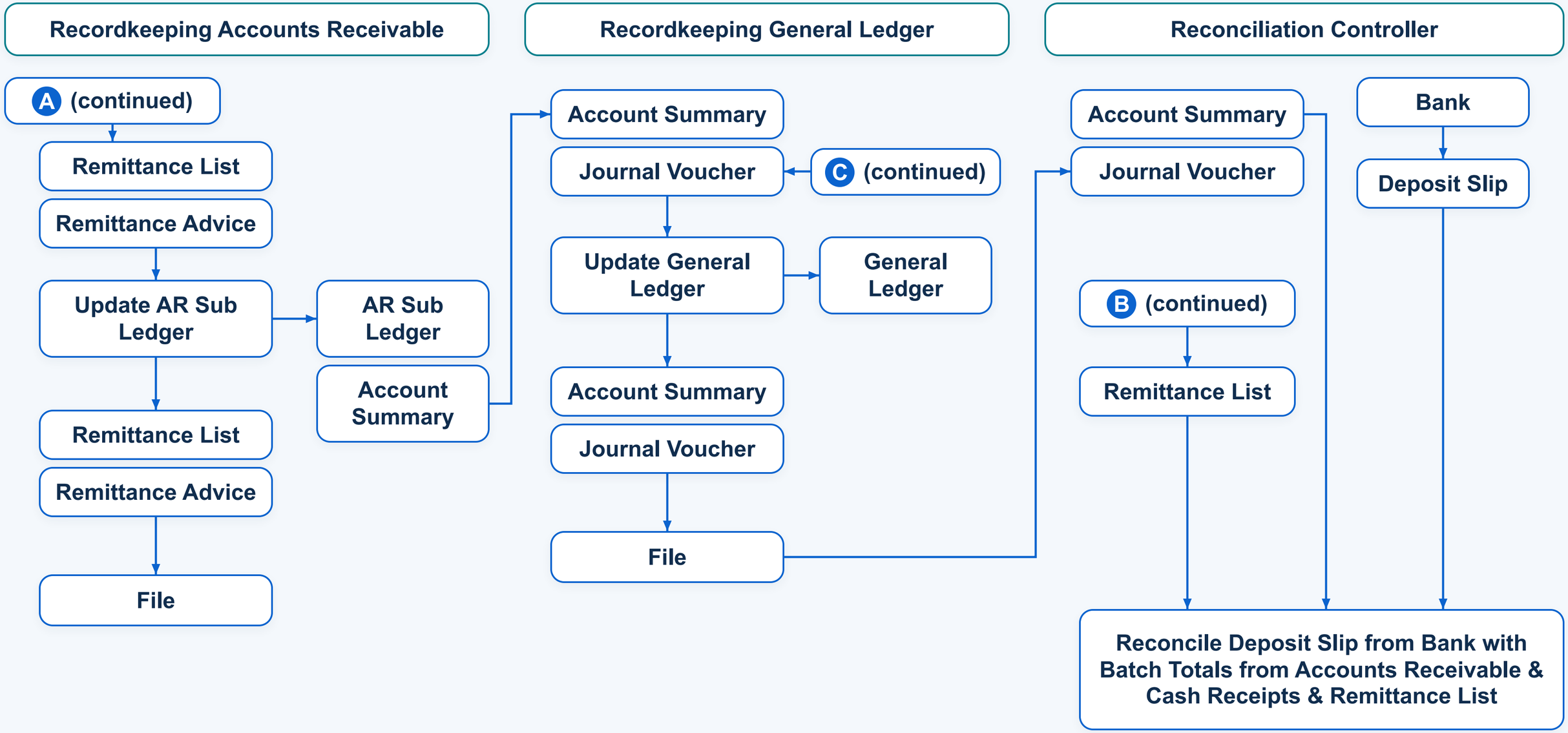
Cash receipts flowchart



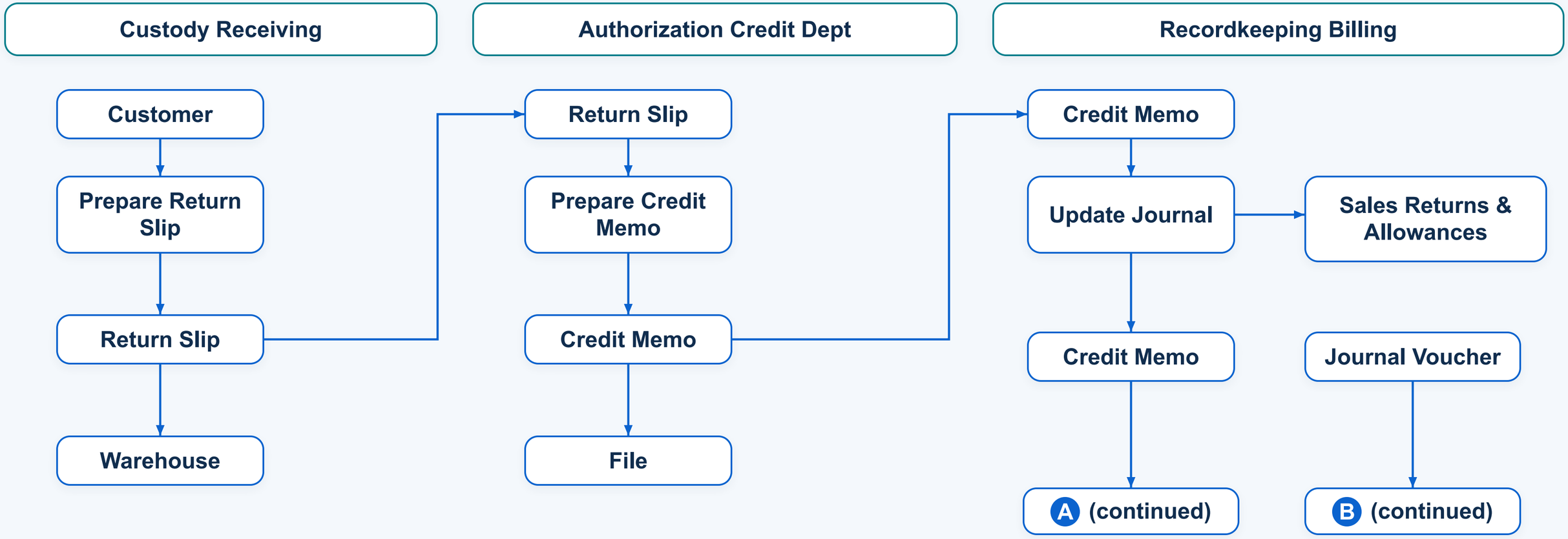
Cash receipts document flowchart



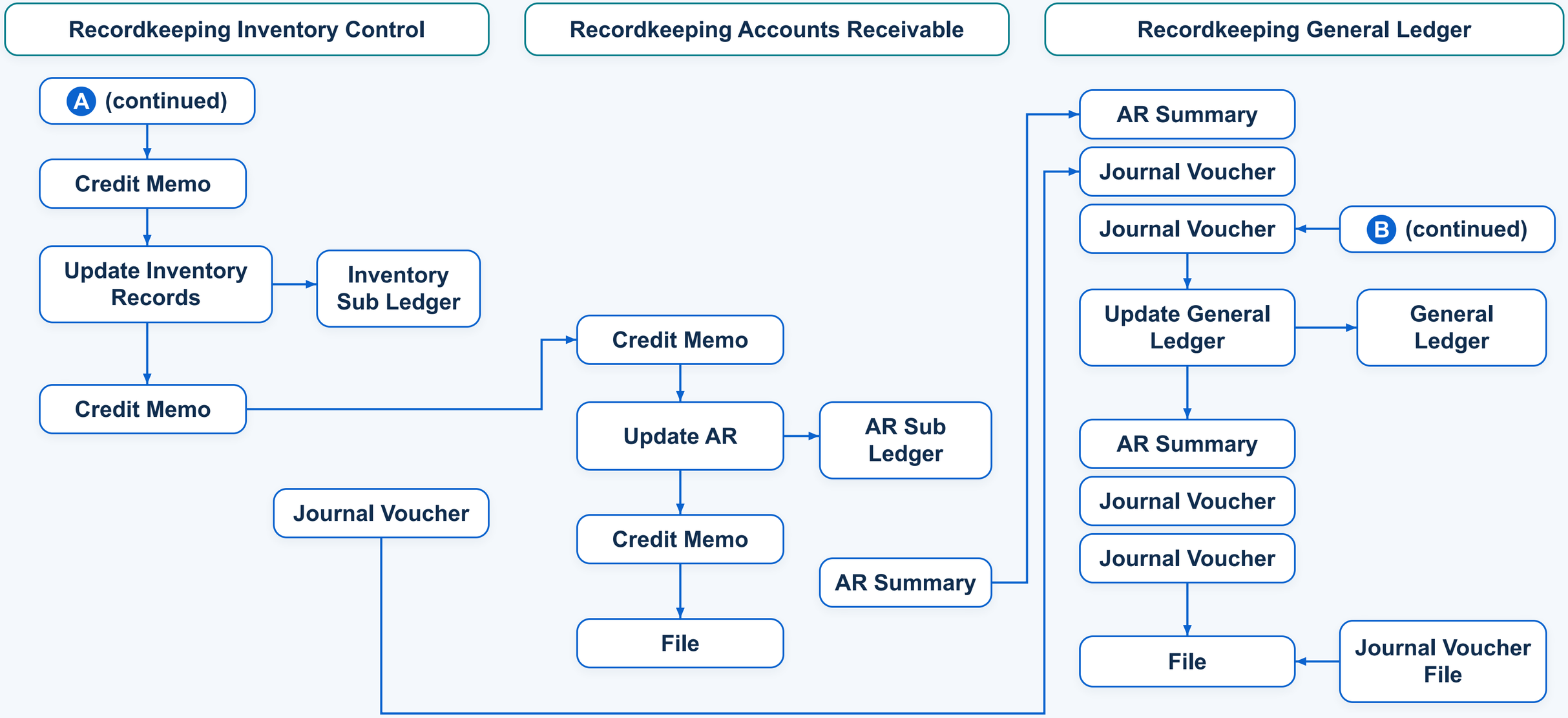
Cash receipts document flowchart (continued)



Sales returns process



Sales returns process (continued)



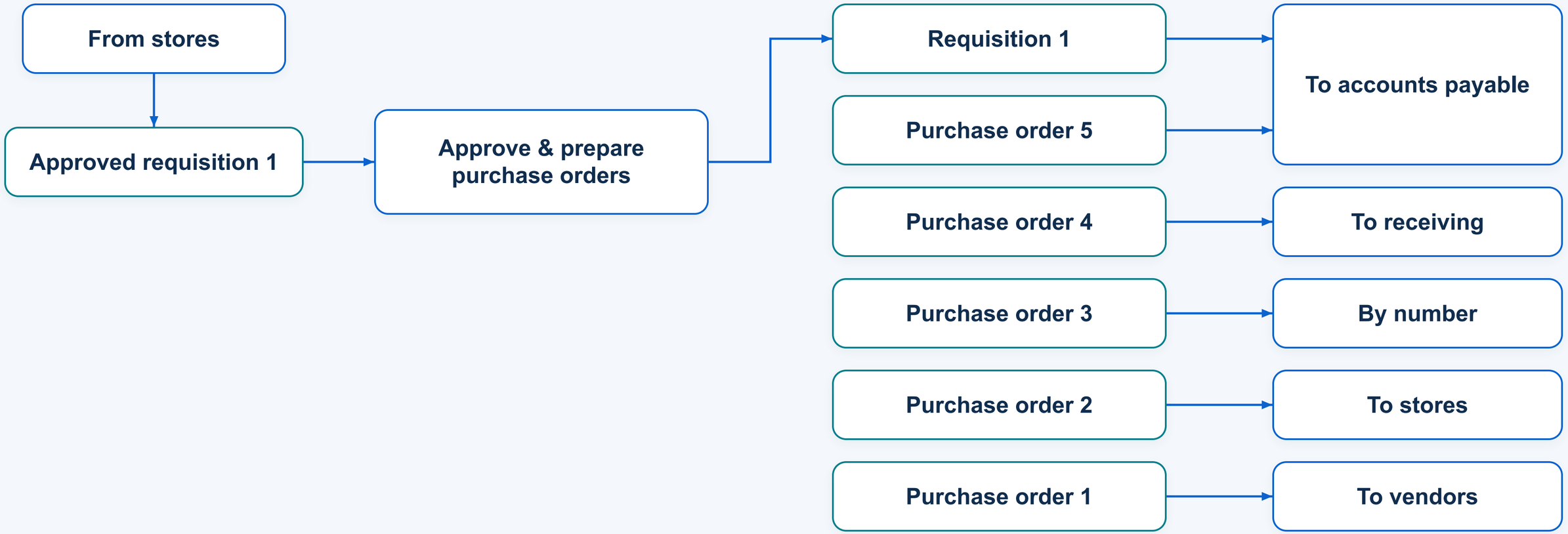
Expenditure cycle

Expenditure Cycle

Component	Related Assertion	Completeness	Cutoff	Valuation, Allocation & Accuracy	Existence & Occurrence	Rights & Obligations	Classification & Presentation
Accounts Payable	Account Balance	• Search for unrecorded liabilities. • Confirm A/P with major vendors, including those with small or zero balances.		• Foot accounts payable listing and agree to general ledger. Review accounts payable confirmation results.	• Vouch accounts payable to voucher packages. Confirm accounts payable.	• Review voucher packages for purchase orders, receiving reports and vendor invoices.	
Purchases	Transactions	• Trace vouchers to purchase journal. Account for prenumbered sequencing of receiving reports.	• Compare dates on vouchers with dates of transactions. Examine purchases before and after year end.	• Recompute accuracy of vendor invoices.	• Vouch recorded purchases to vendor invoices, receiving reports and approved purchase orders.		• Verify classification.
Accounts Payable & Purchases	Presentation and Disclosure	• Ensure required disclosures are included.		• Read footnotes.	• Compare to audit evidence to determine occurrence.		• Read required disclosures.

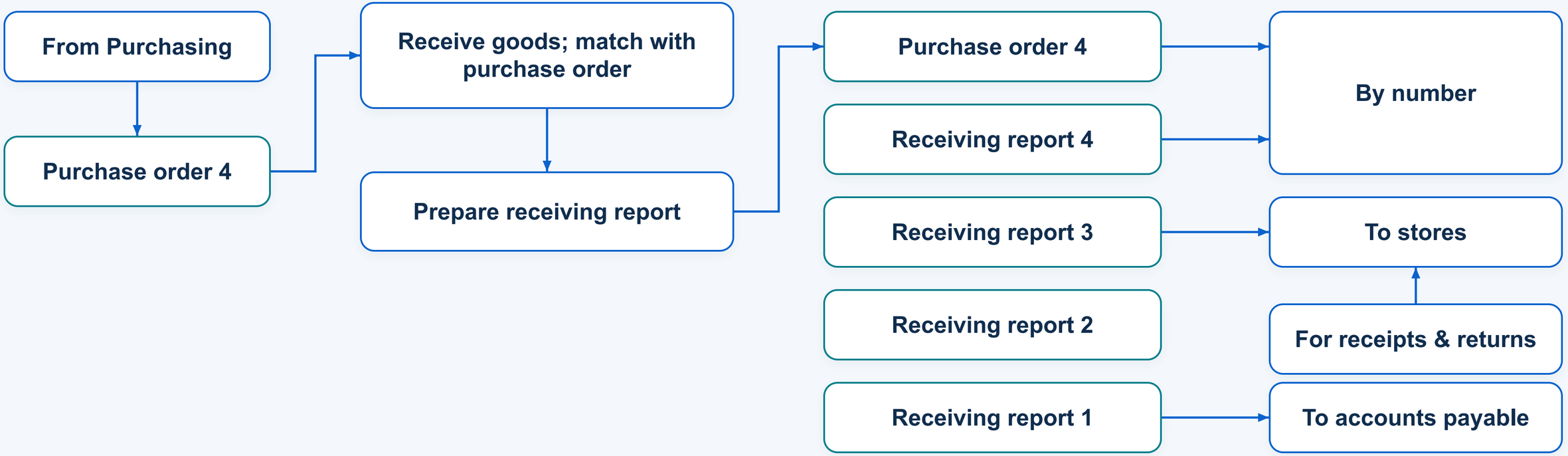
Expenditure cycle

Purchasing



Expenditure cycle (continued)

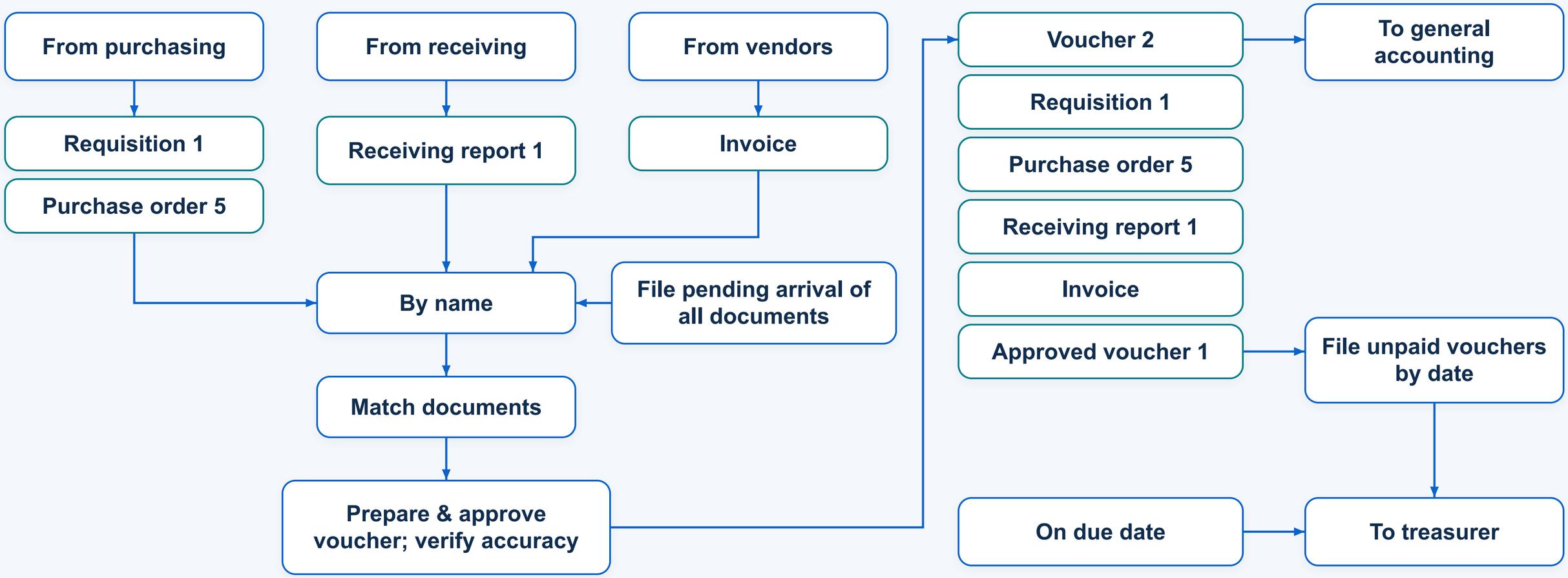
Receiving



Expenditure cycle

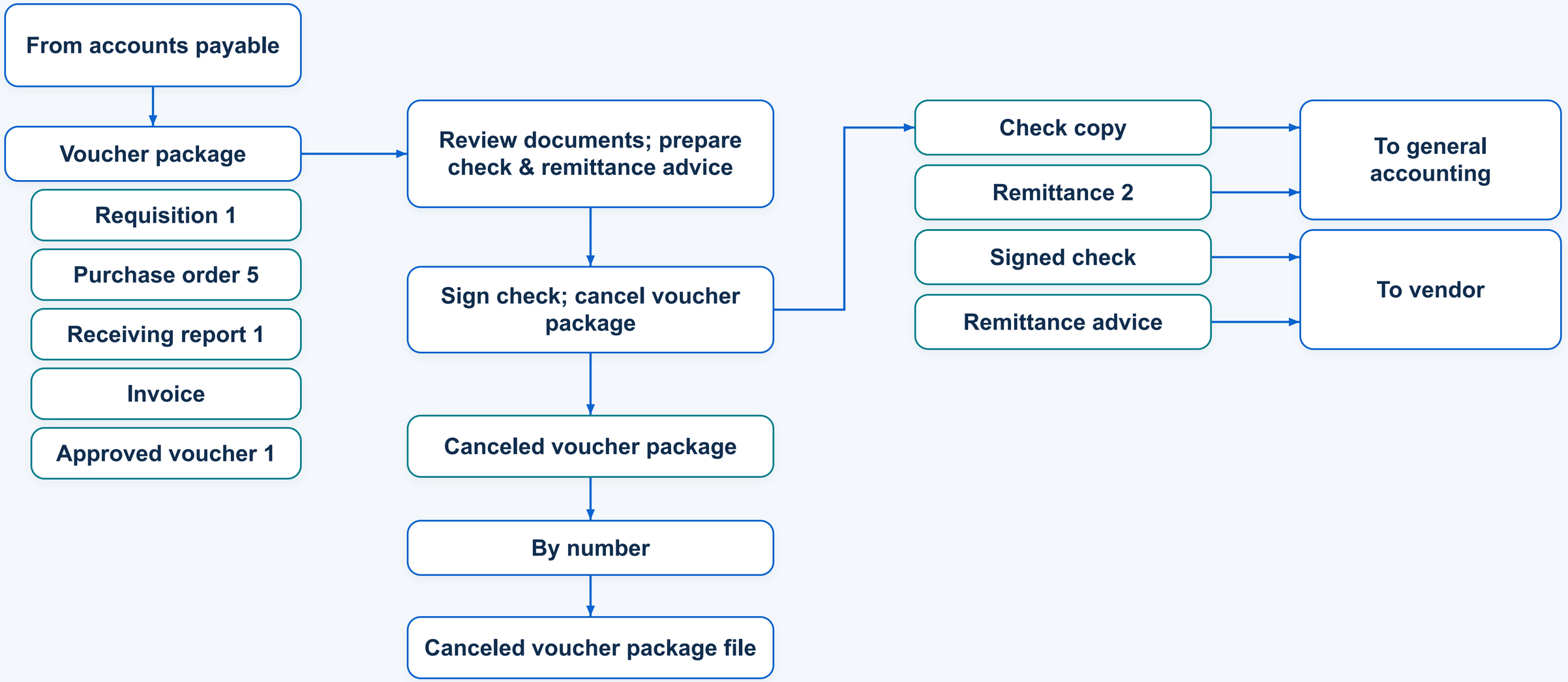
Copernicus CPA Review

Accounts payable



Expenditure cycle (continued)

Treasurer



Cash cycle

Cash Cycle

Component	Related Assertion	Completeness	Cutoff	Valuation, Allocation & Accuracy	Existence & Occurrence	Classification & Presentation
Cash Receipts & Cash Disbursements	Account Balance	• Confirmations (all accounts, even with 0 balance, inc. evidence of loans, contingent liabilities, discounted notes, pledged collateral, guarantees, security agreements.)		• Confirmations.	• Confirmations.	
	Transactions	• Trace remittance advices to cash receipts journal and deposit slips. • Trace canceled checks to cash disbursement journal.	• Compare dates on bank statement with recorded dates.	• Foot remittance advices and agree deposit slips and bank statement. Agree voucher packages with purchase order, receiving report, invoice, cancelled check and disbursement journals.	• Vouch cash receipts to remittance advices to deposit slips and bank statement. • Vouch disbursement journal to voucher packages, cancelled checks, and bank statement.	• Examine sample remittance advices and cancelled checks for proper classification.
	Presentation & Disclosure	• Ensure required disclosures are included.		• Read footnotes.	• Compare to audit evidence to determine occurrence.	• Read required disclosures.

Rights and obligations: confirm account ownership with the bank and review loan agreements for compensating balances, pledges and withdrawal restrictions; evaluate the disclosure.

Sample confirmation form

Standard Form to Confirm Account Balance Information with Financial Institutions

Financial institution: [name and address]
Customer: [entity name]
Balances as of: [balance sheet date]
Prepared by the client; balances usually pre-filled
Signed by the customer (authorized signer)
Mailed or sent by the auditor (CPA firm)
Reply goes directly to the auditor
No comprehensive search of records is requested

The institution confirms each item or notes exceptions and returns the form directly to [the CPA firm or its electronic confirmation platform].

1. Deposits: account name, account number, interest rate, balance
2. Loans: account number, balance, due date, interest rate
3. Loans: date through which interest is paid; collateral
4. Any other deposit or loan accounts that come to its attention
5. Lines of credit and compensating balances: separate letter
6. Guarantees, letters of credit, other contingent liabilities: separate letter

We authorize the bank to respond directly to our auditor.
Customer: (authorized signature, date)
Financial institution reply:
Balances agree, or exceptions are noted
(Authorized official: signature, name, title, date)

The auditor controls sending and receipt; many banks confirm through electronic platforms.

Bank reconciliation

Company Name, Checking Account# ____ Bank Reconciliation as of _____ (date)

Balance per BANK	
Unadjusted balance from the bank statement (or online bank info)	$ xxxx.xx
Adjustments to bank balance:	
Add: Deposits in transit	+
Deduct: Outstanding checks	−
Add: Bank errors (understated)	+
Deduct: Bank errors (overstated)	−
Adjusted balance per Bank	**$ xxxx.xx**

Balance per BOOKS	
Unadjusted balance in the company's general ledger Cash account	$ xxxx.xx
Adjustments to company's books:	
Add: Bank interest earned	+
Add: Auto / electronic deposits	+
Deduct: Bank fees charged	−
Deduct: Check printing cost	−
Deduct: Auto / electronic payments	−
Deduct: Returned checks (NSF)	−
Add: Company errors (understated)	+
Deduct: Company errors (overstated)	−
Adjusted balance per Books	**$ xxxx.xx**

Bank reconciliation (continued)

- Auditing the reconciliation: agree the bank balance to the confirmation and the book balance to the ledger, reperform the reconciliation, trace deposits in transit and outstanding checks to the cutoff bank statement, investigate old reconciling items, and use an interbank transfer schedule to detect kiting.

Inventory cycle

Inventory Cycle

Cutoff: at the count, record the last receiving and shipping document numbers and trace them to the records.

Related Assertion	Completeness	Valuation, Allocation & Accuracy	Existence & Occurrence	Rights & Obligations	Classification & Presentation
Account Balance	• Trace test counts to report. • Trace prenumbered tags to physical inventory report sheets.	• Test accuracy of inventory report and reconcile to general ledger. • Inquire about obsolete or damaged goods. • Scan records for slow moving inventory. • Examine vendor invoices, review labor rates, recompute overhead rates and review variance analyses.	• Observation of inventory count. • Verify physical inventory report to items and test count. • Vouch inventory report sheet to prenumbered inventory tags.	• Review shipping terms and consigned inventory.	
Presentation and Disclosure	• Ensure required disclosures are included.	• Read footnotes.	• Compare to audit evidence to determine occurrence.	• Inquire of management and read loan agreements and board meeting minutes. • Identify inventory pledged as collateral or held on consignment and evaluate the disclosures.	• Read required disclosures. • Review inventory records for proper classification of direct materials, work in process, and finished goods.

Inventory cycle (continued)

- If inventory is material, attend the count (observe, inspect, test count), unless impracticable; if the count is not at year end, test the roll-forward; if attendance is impracticable, perform alternative procedures, and modify the opinion only if they cannot provide sufficient evidence.
- Material inventory held by third parties: confirm quantities and condition, or inspect or perform other procedures.
- Cutoff: record the last shipping and receiving document numbers at the count and trace them to the records.

Investment cycle

Investment Cycle

Related Assertion	Completeness	Cutoff	Valuation, Allocation & Accuracy	Existence & Occurrence	Rights & Obligations	Classification & Presentation
Account Balance	• Search for unrecorded purchases by examining after year end purchases. • Confirm securities held by custodian. • Request information from counterparty. • Analytical procedures for expected interest earned to actual interest earned.		• Foot investments by category and agree to general ledger. • Review schedule of investment activity. • Corroborate year end fair values from published sources or independent broker-dealer. • Recalculate amortized cost for held-to-maturity debt securities (net of any allowance for credit losses); corroborate fair values for securities carried at fair value. • Look for significant influence and impairment. • Assess assumptions and market variables.	• Confirmation of securities. • Examination of securities on hand. • Analytical procedures.	• Confirmation of securities. • Examination of securities on hand. • Examine broker advices and verify ownership.	

Investment cycle (continued)

Related Assertion	Completeness	Cutoff	Valuation, Allocation & Accuracy	Existence & Occurrence	Rights & Obligations	Classification & Presentation
Transactions	• Analytical procedures on reasonableness of dividend and interest income.	• Review before & after year end.	• Analytical procedures on expected gains, losses and amortization. • Recalculate dividend and interest income. • Compare credit ratings to rating agency reports.	• Analytical procedures on reasonableness of dividend and interest income.		• Review transactions for proper classification. • Unrealized gains and losses on available-for-sale debt securities go to other comprehensive income (OCI) (credit losses go to earnings). • Unrealized gains and losses on trading debt securities and on equity securities go to net income
Presentation & Disclosure	• Ensure required disclosures are included.		• Read footnotes.	• Compare to audit evidence to determine occurrence.	• Inquire of management. • Read loan agreements & board minutes to determine any assets pledged as collateral.	• Read required disclosures.

PP&E cycle

PP&E Cycle

Related Assertion	Completeness	Cutoff	Valuation, Allocation & Accuracy	Existence & Occurrence	Rights & Obligations	Classification & Presentation
Account Balance	• Trace fixed assets to sub ledger.		• Foot fixed asset schedule to GL. • Foot schedule of additions and disposals to fixed asset schedule. • Recalculate accumulated depreciation. • Evaluate impairment.	• Vouch additions in sub ledger to purchase documents. • Physically inspect major additions selected from the fixed asset subledger.	• Examine invoices, deeds and title documents.	
Transactions	• Trace requisitions to receiving reports & sub ledger. • Review repairs and maintenance expense for items that should be capitalized; review lease agreements for unrecorded right-of-use assets.	• Review fixed asset additions and disposals before & after year end.	• Recalculate depreciation expense.	• Vouch purchases to receiving report and invoices.		• Examine significant charges to repair and maintenance.

PP&E cycle (continued)

Related Assertion	Completeness	Cutoff	Valuation, Allocation & Accuracy	Existence & Occurrence	Rights & Obligations	Classification & Presentation
Presentation and Disclosure	• Ensure required disclosures are included.		• Read footnotes.	• Compare to audit evidence to determine occurrence.	• Inquire about loan agreements and board meeting minutes.	• Read required disclosures.

Payroll cycle

Payroll Cycle

Related Assertion	Completeness	Cutoff	Valuation, Allocation & Accuracy	Existence & Occurrence	Rights & Obligations	Classification & Presentation
Account Balance	• Search for unrecorded liabilities.		• Recalculate year end accrual.	• Vouch recorded accruals to client's calculations.	• Examine documents to determine company's obligations.	
Transactions	• Trace time cards to payroll register.	• Examine time cards before & after year end.	• Compare payroll recorded with checks issued. • Foot payroll. • Verify pay rates and deductions. • Recalculate gross and net pay. • Compare with budget. • Recompute sample checks.	• Vouch time on payroll summaries to time cards and approved time reports. • Verify employee current employment status.		• Examine payroll distribution for classification.
Presentation and Disclosure	• Ensure required disclosures are included.		• Read footnotes.	• Compare to audit evidence to determine occurrence.	• Inquire about accruals.	• Read required disclosures.

Financing cycle - debt and equity

Financing Cycle

Component	Related Assertion	Completeness	Cutoff	Valuation, Allocation & Accuracy	Existence & Occurrence	Rights & Obligations	Classification & Presentation
Debt	Account Balance	• Review board minutes. • Trace debt contracts to financial statements. • Agree debt listing to general ledger. • Send confirmations. • Inquire of management.		• Examine new debt agreements. • Recompute interest payable and amortization.	• Confirmations.	• Examine note & bond agreements.	
	Transactions	• Examine note and bond agreements. • Review interest expense payments. • Examine lease agreements.	• Review debt activity before & after year end.	• Test debt receipts & payments and compare interest expense to debt balance for reasonableness.	• Review board minutes and inspect agreements.		• Examine due dates for short term vs long term classification.
	Presentation and Disclosure	• Ensure required disclosures.		• Read footnotes.	• Compare to audit evidence to determine occurrence.		• Read required disclosures.

Financing cycle - debt and equity (continued)

Component	Related Assertion	Completeness	Cutoff	Valuation, Allocation & Accuracy	Existence & Occurrence	Rights & Obligations	Classification & Presentation
Equity	Account Balance, Transactions, Presentation and Disclosure	• Send confirmations and examine stock certificates. • Foot shares outstanding, agree to general ledger. • Examine treasury stock and agree to general ledger. • Ensure required disclosures.		• Recompute value assigned to stock transaction. • Analyze retained earnings account from inception or last audit.	• Vouch transaction records to board minutes. • Send confirmations. • Inspection of stock certificates.		• Determine if there are restrictions on retained earnings from loans, agreements or state law. • Inquire of management regarding appropriations or restrictions.

Contingency treatments

Management's representation & responsibility for disclosing related parties, going concern, litigation, estimates, & more

Contingency Treatments	Accrue Amounts	Disclosure		Ignore
		Amount	Nature	
Loss contingency that is probable and:				
Amount or range can be reasonably estimated	(best estimate; minimum of range if no amount is better)	range	✓	
Amount or range cannot be reasonably estimated			✓	
Loss contingency that is a reasonable possibility		range	✓	
Loss contingency that is remote, but is a guarantee for others		✓	✓	
Gain contingencies that are probable or reasonably possible		✓	✓	
Loss contingency that is remote				✓
Gain contingencies that are remote				✓

If no estimate can be made, disclose the nature and state that an estimate cannot be made.

Contingency treatments (continued)

Management's representation & responsibility for disclosing related parties, going concern, litigation, estimates, & more

- Guarantees: disclose even if loss is remote; Accounting Standards Codification (ASC) 460 may also require a liability at inception for the stand-ready obligation.

Going concern

Management's representation & responsibility for disclosing related parties, going concern, litigation, estimates, & more

The following are reasons that an entity could have issues continuing as a going concern:

- Negative trends in financial operating results.
- Defaulting on loans.
- Uninsured massive disaster.
- Credit denials by suppliers or financial institutions.
- Continuous losses.
- Operations being halted.
- Significant adverse market or legal changes.
- Negative operating cash flows.
- Inability to pay dividends that were already declared.

The auditor evaluates management's plans: substantial doubt is alleviated only if it is probable that the plans will be effectively implemented and probable that they will mitigate the conditions. Possible plans include:

- Debt restructuring to lower rates and renegotiation of due dates and/or amounts.
- Increasing ownership equity.
- Reducing expenses.
- Reductions in dividend payments.
- Feasible business plans which would reasonably increase cash flows.

Pending litigation

Management's representation & responsibility for disclosing related parties, going concern, litigation, estimates, & more

Audit Procedures:

- Inquire of management about their controls for evaluating litigation as well as a listing of current litigation.
- Obtain from management a description and evaluation of litigation, claims, and assessments existing at the balance sheet date and through the date furnished.
- Obtain assurance from management that it has disclosed all unasserted claims that its legal counsel has advised are probable of being asserted and must be disclosed.
- Review IRS reports and tax returns.
- Review Board Minutes.
- Client Attorney Letter.

The CPA should ask for the nature, progress, probability of outcome, & amount or range of loss.

If management refuses permission to communicate with external legal counsel, that is a management-imposed scope limitation and the opinion must be modified: qualify if the possible effects are material but not pervasive; disclaim, or withdraw when practicable, if material and pervasive. If counsel refuses to respond appropriately, first try alternative procedures.

Attorney Limitations

Substantive attention
Agreed materiality limits

Pending litigation (continued)

Management's representation & responsibility for disclosing related parties, going concern, litigation, estimates, & more

- Also review legal expense accounts, outside counsel invoices and correspondence. Management's list covers matters through the date it is furnished, not just year-end.
- Counsel may limit its response to matters given substantive attention and to agreed materiality limits; these are not scope limitations. A refusal to respond is a scope limitation.

Accounting changes chart

Management's representation & responsibility for disclosing related parties, going concern, litigation, estimates, & more

Type of Change	Description	Examples
Change in Accounting Principle	**Replaces one GAAP with another GAAP**	Adoption of a new FASB standard. Changing inventory cost method (LIFO, FIFO, and WA)
Change in Accounting Estimate	**Revision of an estimate because of new information or new experience**	Switching depreciation methods (SL, DDB, etc.). (a change in estimate effected by a change in principle: account for prospectively; the auditor reports on it like a change in principle, AU-C 708) Estimate change of useful life of depreciable asset. Estimate change of residual value of depreciable asset. Estimate change of bad debt %. Change actuarial estimates pertaining to a pension plan. Change in the measure of progress on an over-time contract (e.g., input method to output method) under ASC 606.
Change in Reporting Entity	Change in the entities included, so the statements are in effect those of a different reporting entity (not a business combination or disposal)	Consolidate a subsidiary not previously included in consolidated financial statements. Report consolidated financial statements in place of individual statements.

Accounting changes chart (continued)

Management's representation & responsibility for disclosing related parties, going concern, litigation, estimates, & more

- Report effect (AU-C 708): justified material principle change = unmodified + emphasis-of-matter (EOM) paragraph; estimate change = none; estimate change effected by principle change = treat as principle change; correction of material error = EOM; reporting-entity change = EOM unless from a transaction or event.

Subsequent event examples

These items should all be investigated if they occur after the period end and through the date of the auditor’s report.

Events to be disclosed but not accrued if significant (Type 2):

- Losses of factory, warehouse, plant, etc., from fire or other disaster, loss of significant customer.
- Mergers and acquisitions.
- Issuing bonds or stock; selling business segments or major assets.
- Significant declines in the fair value of assets.

Events that occur after the period, to be accrued for the current period (Type 1):

- Settlements of lawsuits whose cause arose before year-end.
- Information that gives additional evidence about conditions that existed at the balance-sheet date (e.g., a customer's bankruptcy that reveals a year-end receivable was uncollectible).

Dual-dated audit report

The independent auditor has two methods for dating the report when a subsequent event disclosed in the financial statements occurs after the auditor has obtained sufficient appropriate evidence on which to base his or her opinion, but before the issuance of the related financial statements.

The auditor may use "dual dating," for example, "February 16, 20__, except for Note __, as to which the date is March 1, 20__," or may date the report as of the later date. In the former instance, the responsibility for events occurring subsequent to the original report date is limited to the specific event referred to in the note (or otherwise disclosed). In the latter instance, the independent auditor's responsibility for subsequent events extends to the later report date and, accordingly, subsequent events procedures should be extended to that date.

If the auditor chooses not to dual date and chooses to use the latter date, the auditor is taking responsibility for all subsequent events that occurred through the latter date.

Subsequent events timeline

Type 1 Subsequent Event: Existed as of Balance Sheet Date (Recognized)

Type 2 Subsequent Event: Did not exist as of Balance Sheet Date (Not Recognized - Footnote)

Auditor's Report Date: Obtained Sufficient & Appropriate Audit Evidence

Apr. Yr1 → **Nov. Yr1** → **Dec. Yr1** → **Feb. Yr2** → **Mar. Yr2** → **Apr. Yr2**

Examine the latest interim financial statements

Fiscal Yr Ending Date

PRIME TEST

OPTIONS

AFTER

Issue Date

Subsequent events are evaluated through:

Management (Accounting Standards Codification 855): issue date (SEC filers) or available-to-be-issued date (others)
Auditor's procedures: through the auditor's report date (AU-C 560; AS 2801)

PRIME TEST

Post Balance Sheet Transactions
Rep letter from Management
Inquiry
Minutes
Examine latest interim FS

Inquiry

New commitments, borrowing, guarantees
Sales or acquisition of assets
Increase in capital or debt
Assets destroyed or appropriated
Contingency developments
Unusual accounting adjustments

OPTIONS

- Dual Date
- Redate report but extend subsequent-event procedures

AFTER ISSUANCE

If facts would change the report and others rely on it:

- Advise client to disclose and reissue FS
- If the client refuses, the auditor notifies the BOD of the refusal and of additional actions the auditor may take:
  - Notify audit report may no longer be relied on
  - Notify regulatory agencies
  - Notify known persons relying on FS

Reasons for qualified & adverse opinions

Can be either depending on the pervasiveness of the issue:

- The entity has not adequately disclosed going-concern substantial doubt.
- Material noncompliance with laws and regulations not adequately reflected in the financial statements.
- A material related party transaction has occurred and been accounted for appropriately, but it has not been adequately disclosed in the financial statements.
- Improper or unjustifiable departures from GAAP.

The following are reasons an auditor would issue a qualified opinion:

- The set of financial statements omits one of the statements such as the statement of cash flows.

The following are reasons an auditor would issue an adverse opinion:

- Misstatements (including departures from generally accepted accounting principles), individually or in aggregate, are both material and pervasive, so the financial statements do not present fairly in accordance with the applicable framework.

Keep in mind that management may choose not to correct a significant deficiency in internal control if the cost of correcting the condition outweighs the benefit. As such, this would not result in a modification to the opinion.

Reasons for qualified opinions & disclaimer of opinion or withdrawal from engagement

Opinion modification rules:

- Material but not pervasive misstatement = qualified.
- Material and pervasive misstatement = adverse.
- Inability to obtain sufficient appropriate audit evidence, with material but not pervasive possible effects = qualified.
- Inability to obtain sufficient appropriate audit evidence, with material and pervasive possible effects = disclaimer (or withdraw if management-imposed and practicable).
- Misstatement examples (qualified or adverse by pervasiveness): the financial statements contain departures from generally accepted accounting principles.
- A justified, properly accounted-for and disclosed material principle change normally retains an unmodified opinion with emphasis of matter. An unjustified or improperly accounted-for material change can require qualification or an adverse opinion.
- With an appropriate going-concern basis and adequate disclosure, remaining substantial doubt calls for an unmodified opinion and separate going-concern section. Inadequate disclosure can require qualification or an adverse opinion; an inappropriate basis requires an adverse opinion.
- The auditor is unable to express an unqualified opinion because of inadequate disclosure in the financial statements.
- The auditor is unable to express an unqualified opinion because of a material misstatement in the financial statements.

Qualified opinion: explain the matter (and quantify effects if practicable) in the Basis for Qualified Opinion section; the opinion says "except for the effects" (misstatement) or "except for the possible effects" (scope limitation) of that matter.

Reasons for qualified opinions & disclaimer of opinion or withdrawal from engagement (continued)

Scope limitations that alternative procedures cannot resolve: qualified if possible effects are material but not pervasive; disclaimer (or withdraw if management-imposed and practicable) if material and pervasive.

- Client refusing to give the auditor permission to communicate with external third parties or internal members necessary for the audit.
- Investigate inconsistent or unreliable representations. Disclaim or withdraw for missing fundamental responsibility representations, or when sufficient doubt about management integrity makes those representations unreliable.
- Client's attorney refused to respond to a letter of audit inquiry.
- The auditor is unable to determine the extent of or the amounts associated with a pervasive employee fraud scheme.
- Management refuses to produce documentation necessary for the audit.
- Underlying accounting records and corroborating evidence are unavailable.
- If not independent, the auditor cannot issue a GAAS audit report; if law or regulation still requires a report, disclaim and state that the auditor is not independent (AU-C 705.16: reasons optional, but if given, give all, as in AR-C 80 compilations; PCAOB, AS 3320: give no reasons).
- An audit provides reasonable assurance and an opinion; a review provides limited assurance and a conclusion. Preparation and compilation provide no assurance and follow their own reporting rules. Examinations under the attestation standards also provide reasonable assurance and an opinion.
- Inability to obtain sufficient appropriate evidence about a material investee/subsidiary (e.g., no audited financial statements and no alternative evidence) is a scope limitation: qualified if possible effects are material but not pervasive; disclaimer if material and pervasive.

CAMs vs KAMs

CAMs relate to issuers. CAMs are not required for audits of emerging growth companies, brokers and dealers (Rule 17a-5), registered investment companies other than business development companies, and employee stock purchase, savings and similar plans. Otherwise, CAMs are required to be mentioned in the audit report. If there were no CAMs during the audit, then the auditor would include a statement that no CAMs were identified.

KAMs relate to nonissuers. Under AU-C 701, the auditor may be engaged to communicate KAMs as part of the audit engagement. KAMs are communicated in the auditor's report. KAMs are not communicated when the auditor disclaims an opinion. Key audit matters (KAMs) may be communicated with qualification. With a qualified opinion, KAMs may still be communicated; with an adverse opinion or a disclaimer, no KAM section is included (AU-C 705.30).

Both of these matters are challenging areas of the audit which require significant judgment on the part of the auditor.

The auditor communicates critical audit matters (CAMs) and provides a draft report to the audit committee. A CAM is a matter communicated or required to be communicated to the audit committee that relates to material accounts or disclosures and involved especially challenging, subjective or complex auditor judgment (PCAOB AS 3101.11). A key audit matter (KAM) is a matter of most significance, in the auditor's judgment, in the current-period audit, selected from matters communicated with those charged with governance (AU-C 701.08-.09).

The auditor must discuss the draft report, including CAMs, with the audit committee before issuing it. When engaged to report KAMs, the auditor communicates the KAMs (or that there are none) with those charged with governance.

CAMs vs KAMs (continued)

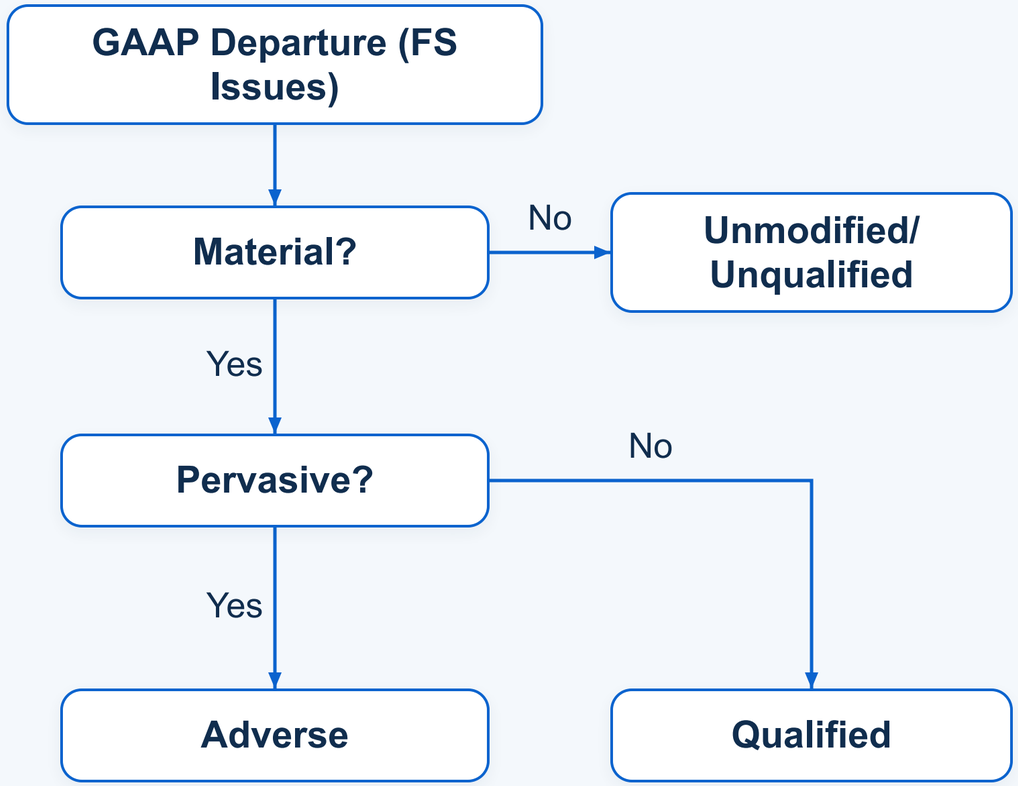
Example CAMs (could also be KAMs):

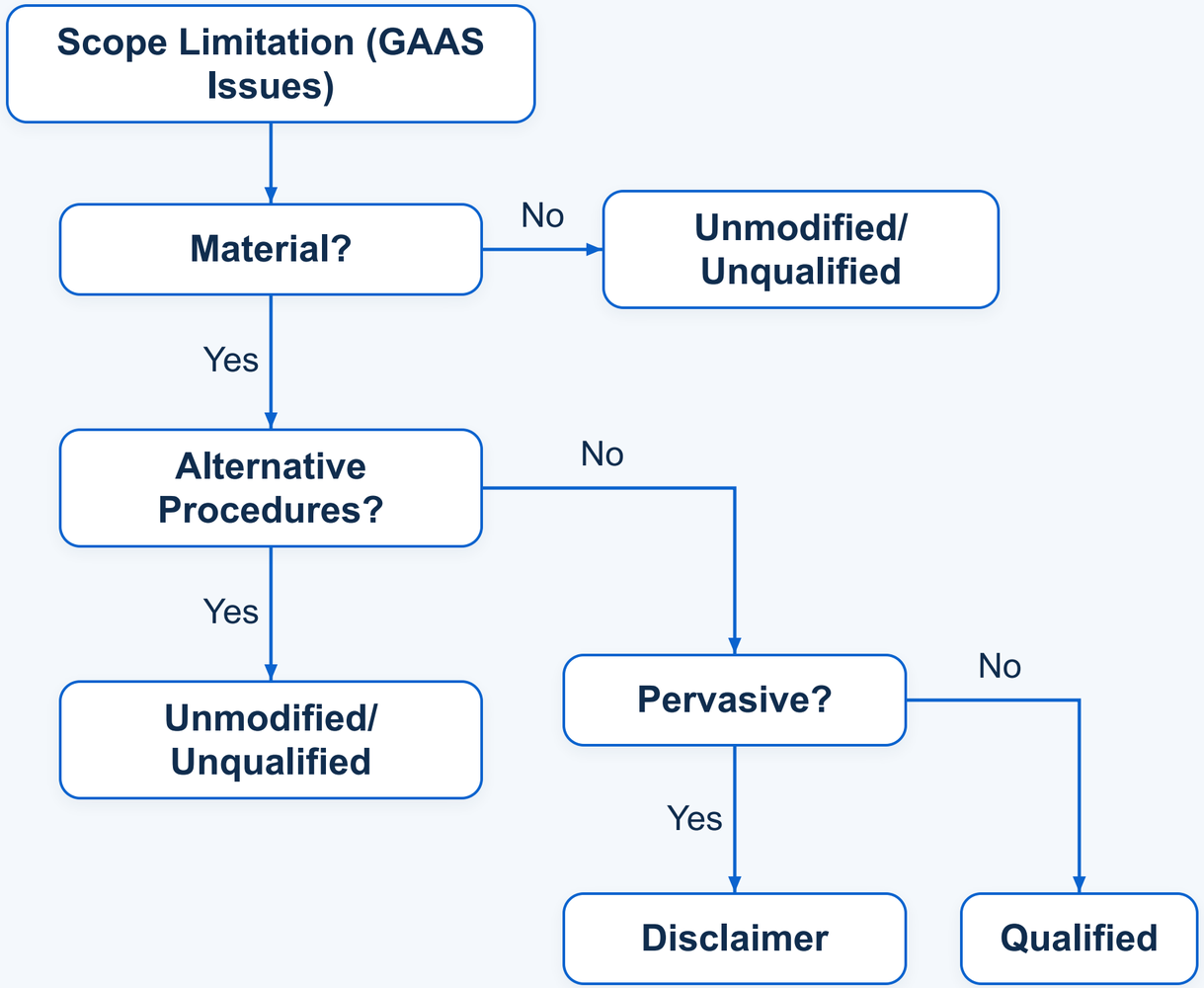
1. Revenue recognition and related reserves
2. Valuation of long-lived assets
3. Valuation of derivatives
4. Valuation of goodwill
5. Valuation of investments in unconsolidated entities
6. Revenue recognition from performance-based contracts
7. Valuation of inventory

Example KAMs (could also be CAMs):

1. Evaluation of complex accounting estimates
2. Valuation of deferred tax assets
3. Assessment of impairment of long-lived assets
4. Evaluation of related party transactions
5. Valuation of investments in equity securities
6. Review of accounting estimates related to income taxes
7. Going concern judgment (doubt alleviated)

Opinion flowchart



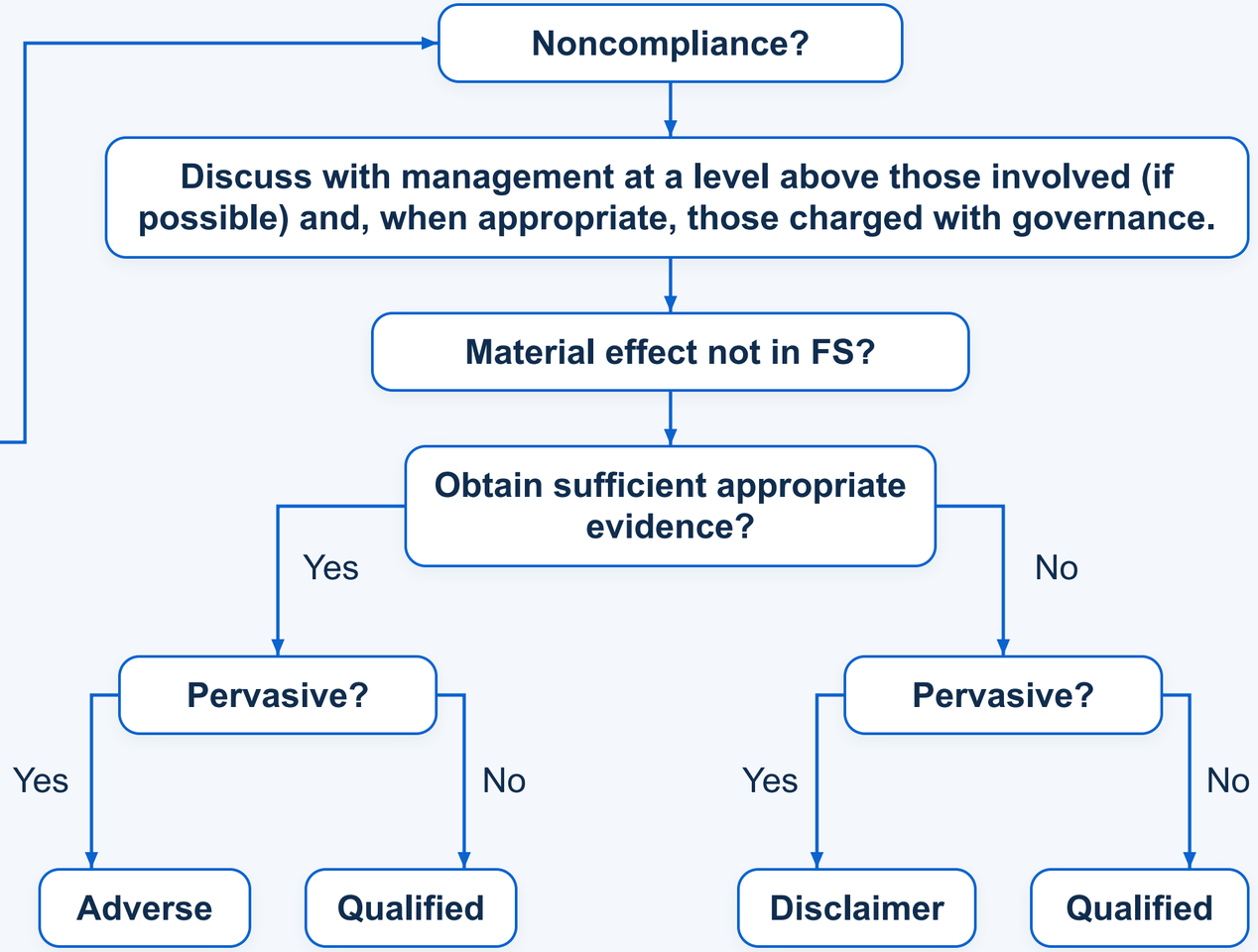


Opinion flowchart: noncompliance with laws

Noncompliance with Laws and Regulations

Compliance with applicable laws & regulations
Direct-effect laws: obtain sufficient appropriate evidence on the material amounts and disclosures they determine. Other laws: limited procedures (inquiry of management and those charged with governance, inspect regulator correspondence); the audit gives no assurance on compliance with all laws.
Auditor cannot be expected to detect all issues
Management has the responsibility to comply
Procedures taken by the auditor would include:

- Inquiries of management
- Inspection of documents



Auditor's report summary (nonissuer)

Auditor's Report Summary (Nonissuer)						
	Type of Opinion	**Opinion Section**	**Basis for Opinion Section**	**Management Responsibility Section**	**Auditor Responsibility Section**	**Key Audit Matters Section**
Misstatement						
Immaterial	Unmodified	Present fairly	Standard	Standard	Standard	When engaged
Material but not pervasive	Qualified	Except for	Amended to describe matter	Standard	Standard	When engaged
Material and pervasive	Adverse	Do not present fairly	Amended to describe matter	Standard	Standard	Do not include
Scope Limitation						
Immaterial	Unmodified	Present fairly	Standard	Standard	Standard	When engaged
Material but not pervasive	Qualified	Except for possible effects	Amended to describe matter	Standard	Standard	When engaged
Material and pervasive	Disclaimer	Engaged to audit, no opinion expressed	Amended to describe matter	Standard	Content limited	Do not include

Auditor’s report summary (issuer)

Auditor's Report Summary (Issuer)

	Type of Opinion	Opinion Section	Additional Paragraph	Basis for Opinion Section	Critical Audit Matters
Misstatement					
Immaterial	Unqualified	Standard	No	Standard	Standard
Material but not pervasive	Qualified	Except for	Yes	Standard	Standard
Material and pervasive	Adverse	Do not present fairly	Yes	Standard	Omit
Scope Limitation					
Immaterial	Unqualified	Standard	No	Standard	Standard
Material but not pervasive	Qualified	Except for	Yes	Except as discussed above	Standard
Material and pervasive	Disclaimer	Engaged to audit and Disclaimer	Yes	Omit certain sentences	Omit
Lack of Independence					
Action taken	Disclaimer	None	None	Disclaimer	Omit

Critical audit matters (CAMs) apply only where the Public Company Accounting Oversight Board (PCAOB) requires them (emerging growth companies (EGCs), brokers and dealers, most registered investment companies and certain employee plans are exempt). Adverse opinions and disclaimers omit CAMs.

Going concern issues

Client is a Going Concern for a Reasonable Period

FASB: Issuance of financials + 1 year

Audit Procedures

Analytical Procedures
Debt Compliance
Minutes of Board
Inquiry of legal counsel
Third-party financial support agreements
Subsequent Event Review

Indicators of Going Concern Issue

Financial Difficulty
Internal Matters
Negative Trends
External Matters

Mitigating Factors

Intent
Ability

Look-forward period: generally accepted accounting principles (GAAP), one year after the financial statements are issued (or available to be issued); Public Company Accounting Oversight Board (PCAOB) auditor, a reasonable period not to exceed one year beyond the balance-sheet date.

Audit Procedures

↓

Conditions that may indicate issues

↓

Consider mitigating factors

↓

Nonissuer: separate going-concern section; issuer: explanatory paragraph

Substantial doubt remains (adequate disclosure): nonissuer = unmodified opinion plus separate section "Substantial Doubt About the Entity's Ability to Continue as a Going Concern"; issuer = explanatory paragraph. Inadequate disclosure = qualified or adverse. Doubt alleviated = emphasis-of-matter paragraph optional.

Statements to include in various report types

<table>
<tr><th>Reports Include a Statement Regarding:</th><th>Compilation Report</th><th>Examination Report</th><th>Agreed-Upon Procedures</th></tr>
<tr><td>Identification of prospective financial statements</td><td rowspan="3">Yes</td><td rowspan="2">Yes</td><td rowspan="5">Yes</td></tr>
<tr><td>Compliance with AICPA standards</td></tr>
<tr><td>Limited nature of the engagement (no opinion or assurance)</td><td rowspan="2">No</td></tr>
<tr><td>An enumeration of procedures performed</td><td>No</td></tr>
<tr><td>A caveat that prospective results may not be achieved</td><td rowspan="2">Yes</td><td rowspan="3">Yes</td></tr>
<tr><td>CPA has no responsibility for updating report</td></tr>
<tr><td>Opinion on Prospective Financial Statements in accordance with AICPA presentation guidelines</td><td>No</td><td>No</td></tr>
<tr><td>Limited use of report</td><td colspan="3">Compilation and examination: restricted use required for a projection (forecast = general use). Agreed-upon procedures (AUP): no required restriction; the practitioner considers whether to add one.</td></tr>
</table>

Which engagement types can a CPA perform an examination, review, or AUP on?

Report Type			
Attestation Service	**Examination**	**Review**	**Agreed-Upon Procedures**
Agreed-upon procedures			✓
Prospective financial statements	✓		✓
Pro forma financial statements	✓	✓	✓
Compliance	✓		✓
MD&A	✓	✓	✓
Service organizations	✓		✓

Type of Engagement	Amount of Assurance	Result	Similar To
Examination	Reasonable (positive)	Opinion	Audit (SAS)
Review	Limited (negative)	Conclusion	Review (SSARS)
Agreed-upon procedures	None	List of findings	N/A

Examinations may be assertion-based or direct (AT-C 206): in a direct examination the practitioner measures the subject matter against criteria, gives reasonable assurance and an opinion; no responsible-party assertion needed. AUP (AT-C 215) may cover any subject matter.

SSAE report formats

	Examination	Review	Agreed-Upon Procedures
Title	Independent Accountant's Report	Independent Accountant's Review Report	Independent Accountant's Report on Agreed-Upon Procedures
Address	✓	✓	✓
Lead In	We have examined [assertion or subject matter]	We have reviewed [assertion or subject matter]	
Management Responsibility	Management responsible for [subject matter] in accordance with [identify criteria]	Management responsible for [subject matter] in accordance with [identify criteria]	We have performed procedures listed below. The engaging party has agreed to and acknowledged that the procedures performed are appropriate for the intended purpose. Management responsible for [subject matter]. The procedures may not meet the needs of all users; users are responsible for determining whether they are appropriate for their purposes.

SSAE report formats (continued)

	Examination	Review	Agreed-Upon Procedures
Enumerate procedures and findings			✓
Practitioner Responsibility	Express opinion Examination conducted in accordance with attestation standards Plan and perform to obtain reasonable assurance	Express conclusion Review conducted in accordance with attestation standards Plan and perform to obtain limited assurance Review substantially less in scope than an examination We do not express opinion	Agreed-upon procedures performed in accordance with attestation standards We did not perform examination or review We do not express opinion or conclusion Had we performed additional procedures, other matters may have come to our attention

SSAE report items

Service	Standard	Engagement Type	Restricted Use	Assurance Type	Caveats
Prospective Financial Statements	SSAE	Examination			
Financial Forecast			General Use Allowed		
Financial Projection			✓		
Pro Forma Financial Statements	SSAE	Examination or Review			
Compliance with contractual or regulatory requirements related to audited FS (AU-C 806)	SAS	Audit	✓	Negative assurance only	Must have audited FS
Compliance	SSAE	Examination		Reasonable Assurance	
		Agreed-Upon Procedures		None	
MD&A		Examination or Review			
Service Organizations**		Examination	✓		

** System and Organization Controls (SOC) Reports
Service org services relevant to financial reporting are part of client's internal control

Type 1	Type 2
Design & Implementation	Design & Implementation + Operating Effectiveness
	May reduce control risk

SSAE report items (continued)

- SOC 1 Type 1: description and design as of a date. Type 2: adds operating effectiveness over a period; only Type 2 can support a lower control-risk assessment, after evaluating period coverage, tests and complementary user entity controls.

When to use emphasis-of-matter paragraphs

Emphasis-of-matter paragraphs that do not affect an auditor’s unmodified opinion would be those describing:

- Significant transactions with related parties.
- That the financial statements are prepared in accordance with a special purpose framework.
- The uncertainty of future events, of which the outcome is not susceptible to reasonable estimation.
- A material, justified change in accounting principle (e.g., inventory method change), properly accounted for and disclosed (required, AU-C 708.08). Note: A change from a non-GAAP principle to a GAAP principle is a **correction of a misstatement (error)**, not a change in principle. If material, the prior statements are restated, and the auditor adds a required emphasis-of-matter paragraph on the correction (opinion stays unmodified if properly corrected and disclosed).
- An uncertainty relating to the future outcome of unusually important litigation or regulatory action.
- A significant subsequent event that occurs between the date of the financial statements and the date of the auditor's report.
- A major catastrophe that has had, or continues to have, a significant effect on the entity's financial position or results of operations.
- A matter of such importance that it is fundamental to the users’ understanding of the financial statements.

When to use other-matter paragraphs

Situations where an other-matter paragraph is used (some required, some at the auditor's discretion):

- Material noncompliance not adequately reflected in the financial statements = qualified or adverse; management prevents evidence = qualified or disclaimer. An other-matter paragraph does not substitute.
- When the opinion on revised financial statements differs from the opinion previously expressed, disclose the prior report date, prior opinion type, reasons for the change and that the opinion differs, in an emphasis-of-matter or other-matter paragraph.
- In situations where auditor is unable to withdraw due to a limitation on the scope of their work which has restricted them from obtaining sufficient appropriate audit evidence. In this case, they may add an other-matter paragraph explaining the reasons why withdrawal was not possible.
- May be used in cases where auditor is engaged to report on two different sets of financial statements where each one is prepared under a different general purpose framework.
- Prior-period financial statements audited by a predecessor whose report is not reissued.
- Prior-period financial statements not audited.
- An alert restricting use is added when the criteria are suitable only for limited users or available only to specified parties, or for an audit by-product report.

Special paragraph usage - comparing the types

AUD

Copernicus CPA Review

Paragraph Type	Emphasis-of-Matter		Other-Matter	Explanatory
Location Relative to Opinion Paragraph	Not Specified		Not Specified	After
Going concern when substantial doubt is alleviated	Optional			
Substantial doubt remains	Report in separate going-concern section			✓
Material justified change in accounting principle	✓			✓
Special purpose framework	✓			✓
Updated opinion on prior-period financial statements differs from the opinion previously expressed	✓	OR	✓	✓
Restrict use of report			✓	✓
Prior financial statements audited by prior auditor and prior auditor's report is not presented			✓	✓
Comparative financial statements where the current year is audited and prior period is not audited			✓	✓
Material inconsistency in other information	Report in separate section			✓
Report on supplementary information within auditor's report	Report in separate section			✓
Refer to required supplementary information	Report in separate section			✓
Report on compliance included in auditor's report			✓	✓

Explanatory column: a check means the report must include explanatory language (an emphasis-of-matter or other-matter paragraph, or a separate section). "After" means the paragraph or section follows the Opinion and Basis for Opinion sections; exact placement is otherwise auditor judgment.

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