Internal Control Audits

* An audit of internal control is available but not required for private entities.
* Auditing standards require an integrated audit of internal control and financial statements.

Compliance Audits

* A compliance audit determines the extent to which rules, policies, laws, covenants, or government regulations are followed by the entity being audited. E.g. Determine whether applicable rules and policies are being followed with respect to the granting of student loans.

Operational Audits

* An operational audit involves a systematic review of part or all of an organization’s activities to evaluate whether resources are being used effectively and efficiently.
* The purpose of an operational audit is to assess performance, identify areas for improvement, and develop recommendations.
* Sometimes referred to as a performance audit or management audit.

Forensic Audits

* A forensic audit’s purpose is the detection or deterrence of fraudulent activities.
* Examples
  + Business or employee fraud
  + Criminal investigations
  + Shareholder or partnership disputes
  + Business economic losses
  + Matrimonial disputes

Services

* Attest Services
  + Attest to the nature and quantity of inventory stored in a client’s warehouse.
* Assurance Services
* Other Nonaudit Services
  + Tax Preparation and Planning Services
    - Assist with preparing and filing tax returns, provide advice on tax and estate planning, and provide representation on tax issues before the IRS or tax courts.
  + Management Advisory Services
    - Consulting activities that may involve providing advice and assistance concerning an entity’s organization, personnel, finances, oeprations, systems, or other activities. You can only perform this to non-audit clients.
  + Compilation and Review Services
    - Bookkeeping, payroll processing, and preparing financial statements.

Organization and Composition

* Local Public Accounting Firms
  + Organized as proprietorships, general partnerships, or corporations.
* Regional, National, and International Accounting Firms
  + Structured as LLPs

Government Regulation

* Sarbanes-Oxley Public Company Accounting Reform and Investor Protection Act
  + Transferred authority to set and enforce auditing standards for public company audits to the PCAOB.
  + Mandated that the SEC impose strict independence rules, prohibiting the provision of many types of nonaudit services to public company audit clients.
  + Rotate audit partners every 5 years
  + Requires an integrated audit (audit of both financial statements and internal control over financial reporting)
* Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010
  + Granting authority to PCAOB to inspect foreign audit firms that practice in the U.S. or that have U.S. clients and by exempting companies with under $75 million market capitalization from the requirement to submit to an audit of internal control over financial reporting.

Business as the Primary Context of Auditing

* Essential Characteristics of a business
  + Corporate Governance
    - Consists of all the people, processes, and activities in place to help ensure proper stewardship over an entity’s assets.
    - Board of Directors
      * Body primarily responsible for management oversight in U.S. corporations.
    - Audit Committee
      * Consists of members of the board, oversees the internal and external auditing work done for the organization.
  + Objectives, Strategies, Processes, Risks, Controls, & Reporting
    - Process Categories / Cycles
      * Financial Process
        + Business obtains capital through borrowing or soliciting investments from owners and typically invests in assets such as land, buildings, and equipment in accordance with their strategies.
      * Purchasing Process
        + Acquisition of goods and services to support their operations.
      * Human Resource Management Process
        + Business organizations hire personnel to perform various functions in accordance with the enterprise’s mission and strategy. Usually begins with an employee performing a job and ends with payment being made to the employee.
      * Inventory Management Process
        + Cost accounting transactions to accumulate and allocate costs to inventory.
      * Revenue Process
        + Generate revenue thru sales of goods or services to customers and collect the proceeds of those sales in cash, either immediately or through collections or receivables.

Securities and Exchange Commission (SEC)

* Federal government agency that administers the Securities Act of 1933, 1934, and SoX.
* Securities Act of 1933
  + Regulates disclosure of material information in a registration statement for an IPO
  + S forms, which are used for issuing the securities, contain the audited financial statements of the registrant.
* Securities Exchange Act of 1934
  + Regulates ongoing reporting by companies whose securities are listed and traded on a stock exchange or that possess assets greater than $1 million and equity securities held by 500 or more persons.
  + 10K, 10Q, and 8K.

Public Company Accounting Oversight Board (PCAOB)

* A nonprofit corporation established by Congress to oversee the audits of public companies in order to protect investors and the public interest by promoting informative, accurate, and independent audit reports.
* The PCAOB can impose sanctions to deter possible recurrence of rule violations and to enhance the quality and reliability of future audits.

American Institute of Certified Public Accountants (AICPA)

* Promulgation of rules and standards that guide audit and related services provided to nonpublic companies, governmental entities such as states, counties, municipalities and school districts, and other entities such as universities and charities.
* Professional Rules & Standards
  + The Code of Professional Conduct
  + Quality control & peer review standards
  + Attestation Standards
  + Compilation and Review Standards

Financial Accounting Standards Board (FASB)

* Privately funded body whose mission is to establish standards for financial accounting and reporting
* FASB Accounting Standards Codifcation (ASC), recognized as the source of GAAP by SEC, PCAOB, and AICPA.
* Emerging Issues Task Force (EITF)
  + Established to meet accountants’ needs for timely guidance on accounting practices and methods and to limit the number of issues requesting formal pronouncements from the FASB.

International Auditing and Assurance Standards Board (IAASB)

* The global organization for the accountancy profession.
* Develop international standards on ethics, education, and public sector accounting standards.
* Issues International Standards on Auditing (ISA) and is the predominantly recognized international auditing standard setter outside of the U.S.

International Accounting Standards Board (IASB)

* International counterpart to the FASB
* Predominately recognized accounting standards outside of the U.S.
* Responsible for the development and publication of International Financial Reporting Standards (IFRS), and for approving Interpretations of IFRS

Auditing Standards

* Three Sets of Auditing Standards: ASB, PCAOB, and IAASB
  + ASB
    - PCAOB adopted the ASB standards that existed as of April 2003 and labeled them “interim standards of the PCAOB”
  + PCAOB
    - Adopted ASB standards. Required for all public company audits.
  + IAASB
    - Global accounting firms, which provide financial statement audits for nonpublic U.S. entities, U.S. public companies, and international companies around the world must adhere to ASB, PCAOB, and IAASB.

The 10 Generally Accepted Auditing Standards

* ASB first issued the 10 generally accepted auditing standards (GAAS) in 1947.
* Three Categories: General Standards (3), Standards of Field Work (3), and Standards of Reporting (4)
* General Standards
  + The audit is to be performed by a person or persons having adequated technical training and proficiency as an auditor
  + In all matters relating to the assignment, an independence in mental attitude is to be maintained by the auditor or auditors.
  + Due professional care is to be exercised in the performance of the audit and the preparation of the report
* Standards of Field Work
  + The work is to be adequately planned and assistants, if any, are to be properly supervised.
  + A sufficient understanding of internal control is to be obtained to plan the audit and to determine the nature, timing, and extent of tests to be performed.
  + Sufficient appropriate evidential matter is to be obtained through inspection, observation, inquiries, and confirmations to afford a reasonable basis for an opinion regarding the financial statements under audit.
* Standards of Reporting
  + The report shall state whether the financial statements are presented in accordance with GAAP
  + The report shall identify those circumstances in which such principles have not been consistently observed in the current period in relation to the preceding period
  + Informative disclosures in the financial statements are to be regarded as reasonably adequate unless otherwise stated in the report
  + The report shall contain either an expression of opinion regarding the financial statements, taken as a whole, or an assertion to the effect that an opinion cannot be expressed. When an overall opinion cannot be expressed, the reasons therefore should be stated. In all cases where an auditor’s name is associated with financial statements, the report should contain a clear-cut indicator of the character of the auditor’s work, if any, and the degree of responsibility the auditor is taking.

Three General Standards

* The three general standards deal with the auditor’s qualifications and the quality of his or her work.
* The auditor must have adequate training and proficiency gained through formal education, continuing education programs, and experience.
* The second general standard requires that the auditor maintain an attitude of independence on an engagement.
* Must be independent in fact but also appearance.
* Due professional care is the focus of the third general standard.
* Due care means that the auditor plans and performs his or her duties with the skill and care that is commonly expected of accounting professionals.

Three Standards of Field Work

* Relate to the actual conduct of the audit
* Provide a conceptual background for the audit process
* First standard deals with planning and supervision. Proper planning leads to a more effective audit that is more likely to detect material misstatements and facilitates completing the engagement in a reasonable amount of time.
* The second standard requires that the auditor gain a sufficient understanding of the entity’s internal control to effectively plan the nature, timing, and extent of further audit procedures.
  + Nature – What procedures are performed
  + Timing – When the audit work is to be done
  + Extent – Refers to how much work is done
* Third standard requires sufficient and appropriate evidence.
  + Search for and evaluate the evidence regarding management’s assertions in the financial statements.

Four Standards of Reporting

* Require that the auditor consider each of the following issues before rendering an audit report
  + Whether the financial statements are presented in accordance with GAAP
  + Whether those principles are consistently applied
  + Whether all appropriate disclosures have been made
  + What degree of responsibility the auditor is taking, as well as the character of the auditor’s work.

The ASB replaced the 10 GAAS with a more comprehensive and coherent description of “the principles underlying an audit conducted in accordance with GAAS.” Grouped into four categories:

* The purpose and premise of an audit
* Personal responsibility of the auditor
* Auditor actions in performing the audit
* Reporting

Principles Underlying an Audit Conducted in Accordance with GAAS

* Purpose of an Audit and Premise upon which an Audit is Conducted
  + The purpose of an audit is to provide financial statement users with an opinion by the auditor on whether the financial statements are presented fairly, in all material respects, in accordance with the applicable financial reporting framework. An auditor’s opinion enhances the degree of confidence that intended users can place in the financial statements
  + An audit in accordance with GAAS is conducted on the premise that management and, where appropriate, those charged with governance have responsibility
    - For the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; and
    - To provide the auditor with
      * All information, such as records, documentation, and other matters that are relevant to the preparation and fair presentation of the financial statements;
      * Any additional information that the auditor may request from management, and where appropriate, those charged with governance; and
      * Unrestricted access to those within the entity from whom the auditor determines it necessary to obtain audit evidence.
* Responsibilities
  + Auditors are responsible for having appropriate competence and capabilities to perform the audit; complying with relevant ethical requirements; and maintaining professional skepticism and exercising professional judgment, throughout the planning and performance of the audit.
* Performance
  + To express an opinion, the auditor obtains reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error.
* To obtain reasonable assurance, which is a high, but not absolute, level of assurance, the auditor
  + Plans the work and properly supervises any assistants
  + Determines and applies appropriate materiality level or levels throughout the audit
  + Identifies and assesses risks of material misstatement, whether due to fraud or error, based on an understanding of the entity and its environment, including the entity’s internal control.
  + Obtains sufficient appropriate audit evidence about whether material misstatements exist, through designing and implementing appropriate responses to the assessed risks
* The audit or is unable to obtain absolute assurance that the financial statements are free from material misstatement because of inherent limitations, which arise from:
  + The nature of financial reporting;
  + The nature of audit procedures; and
  + The need for the audit to be conducted within a reasonable period of time and so as to achieve a balance between benefit and cost
* Reporting
  + Based on an evaluation of the audit evidence obtained, the auditor expresses, in the form of a written report, an opinion in accordance with the auditor’s findings, or states that an opinion cannot be expressed. The opinion states whether the financial statements are presented fairly, in all material respects, in accordance with the applicable financial reporting framework.

Auditing Standards and the AU Codification

* Statements on Auditing Standards (SAS) are issued by the ASB
* The SAS are considered to be the minimum standards of performance for auditors
* The PCAOB adopted the ASB’s SAS as constituted at April 2003.
* Standards issued by the PCAOB are simply called “Auditing Standards” (AS)

Definitions

Professional Skepticism – An attitude that includes a questioning mind and a critical assessment of audit evidence.

Ethics – Refers to a system or code of conduct based on moral duties and obligations that indicate how we should behave

Professionalism – The conduct, aims, or qualities that characterize a profession or professional person. The AICPA establishes guidance for acceptable behavior for auditors.