

What are the requirements for an audit report? Must conform to GAAP
Consistency with prior period reporting is implied (must state if inconsistent)
Adequacy of disclosure is implied (must state if disclosures are lacking)
Opinion is provided - provides assurance
Must be signed by the auditor, and dated.

;How should an audit report be adjusted if reporting is not consistent with the prior period?

If inconsistent, but Unqualified Opinion is ok
Explanatory paragraph after Opinion is added.
Otherwise, Qualified Opinion issued

;When is consistency not violated with respect to changes in reporting between years?

Accounting Errors
Reclassifications
Prospective treatment of a new principle
Accounting Estimate Change

;What assurance is provided in an audit opinion? The opinion states that the financial statements are fairly presented in all material respects
The opinion states if the financials are in conformity with GAAP.

;What are the sections of the audit report? Title - States that the auditor is independent
To - whomever hired the auditor
Introduction Paragraph
Scope Paragraph
Opinion Paragraph

;Which statements are included in the Scope Paragraph of the audit report? "GAAS was followed (IF SEC company, use "the standard of the PCAOB")
Reasonable assurance about material misstatements was obtained.
Financial statements and disclosures are supported by evidence.
Management estimates evaluated
Accounting principles evaluated
Financial presentation evaluated
Reasonable basis exists for an opinion
If any scope limitations exist, the auditor tries to work around them and still issue an unqualified opinion if possible."

;For an unqualified opinion to be issued, what must be the case with all period presented?

A prior year's F/S used for comparative purposes must also meet criteria for an Unqualified Opinion
If an exception arises, the Explanatory and Opinion paragraphs will address the issue
If a prior year's issue has been corrected, issue an Unqualified opinion and ignore the past issue

;What is included in an unqualified opinion paragraph with an emphasis? Includes:
Immaterial GAAP issues
Going Concern worries
Auditor shares responsibility
Emphasizing a particular aspect of F/S
Unqualified Opinion/Assurances not affected
Explanatory paragraph added after opinion

;What is the effect of a qualified opinion? A qualified opinion creates reduced assurances.
It results from scope limitations or major inconsistencies.
It includes material problems with GAAP, disclosures, or segment reporting.
If there is an issue that causes a Qualified Opinion, the explanatory paragraph goes after the Scope and before the Opinion paragraphs and the Opinion paragraph refers to the issue as well.

;How is the audit report changed if there is Scope Limitation? Qualified opinion is issued.
Scope paragraph modified
Explanatory paragraph between Scope and Opinion paragraphs
Opinion paragraph points out scope limitation

;How is the audit report modified for major inconsistencies found during the audit?

Qualified opinion is issued.
Scope paragraph remains unchanged
Explanatory paragraph between Scope and Opinion paragraphs
Opinion paragraph points out inconsistency

;How does a Disclaimer of Opinion affect the audit report? States that an opinion cannot be issued.
Creates negative assurances
Includes severe Scope limitation

;What would cause an Adverse Opinion? Very material GAAP and Disclosure issues would cause an Adverse Opinion.
If there is an issue that causes an Adverse Opinion, the explanatory

paragraph goes after the Scope and Before the Opinion paragraphs and the Opinion paragraph refers to the issue as well

;How is division of auditor responsibility disclosed? Disclosed in Introductory Paragraph. Doesn't name the other auditor without permission. Referenced in Opinion paragraph and division of responsibility indicated. If other auditor is not referenced, then you take responsibility for their conclusions, so consideration of independence, experience, credentials, etc required

;What standards govern SSARS engagements? Compilations are governed by SSARS (Statements on Standards for Accounting and Review Services)

;Which clients can have compilation engagements? Non-SEC (non-public) registrants only.

;What is a compilation? Accountant puts together financial statements with information PROVIDED BY MANAGEMENT. No opinion is expressed, and no assurances are given. Independence is not required.

;What disclosures are required for Compilation engagements? Disclosures not necessary – must state that they are not included

;What standards govern Review engagements? SSARS (Statements on Standards for Accounting and Review Services)

;What type of assurance is given in a Review engagement? Reviews give NEGATIVE assurance.

;What procedures are required for Review engagements? Analytical procedures are required for reviews. Compare actuals to documented predictions.

;What is a Review engagement? Financial statements are presented with no opinion expressed, and limited assurances are given. Independence is required for a review engagement.

;What is a Forecast? A prospective financial statement that uses normal circumstances. General and limited use are allowed.

;What is a Projection? A prospective financial statement using hypothetical situations. Only limited use by the client is allowed.

;What are the requirements for Agreed Upon Procedures? Independence is required. Only limited use by the client is allowed.

;What disclosures are required for remote likelihood of losses? No disclosure required.

;What disclosure is required for a probable loss contingency? Accrue if estimable. Explanatory paragraph if not estimable.

;What disclosure is made if a loss contingency is reasonably possible? Auditor assesses need for explanatory paragraph based on loss likelihood.

;How is a gain contingency reported? Gain contingencies are not reported.

;How does an immaterial GAAS issue affect the audit opinion? It doesn't. Opinion is unqualified.

;How does a material GAAS issue affect the audit opinion? Qualified Opinion is issued. Similar to Scope Limitation. Explanatory paragraph after Scope Paragraph. Opinion refers to GAAP issue.

;How does a very material GAAS issue affect the audit report? Adverse opinion is issued. Same paragraph structure as a Qualified opinion.

;How does a Going Concern issue affect the audit report? Unqualified opinion is ok. Explanatory paragraph is added after Opinion paragraph.

;"What is a ""Yellow Book"" audit?" An audit performed under governmental auditing standards (GAS).

;How do GAS standards compare to GAAS? GAS is more strict than GAAS.

;What is required under the Single Audit Act? A report on internal control is required. GAAS and GAS don't require the I/C report.

;What is the primary duty of an auditor? To provide users of financial information with REASONABLE ASSURANCE that the financial statements are not materially misstated.

;What is the auditor's responsibility for detecting theft or fraud? Auditors are *not* responsible for detecting theft or fraud. Instead, they are responsible for providing REASONABLE ASSURANCE that the financial statements are not materially misstated.

;When should an auditor be hired in relation to the balance sheet date for optimum audit planning and efficiency? The earlier the auditor is hired, the better for audit planning and efficiency.

;When can audit procedures be performed at interim dates? If Control Risk for the accounts and/or transactions is low, audit procedures can be performed at interim dates. The auditor then reviews changes in the balances at year-end.

;When can an auditor accept an engagement offered after the year is already closed? The auditor can take the engagement if they are able to overcome the limitations of the engagement.

;For what does an auditor use professional skepticism? To plan the scope of the audit. To plan the objectives of the audit.

;How can analytical procedures be performed in audit planning? The auditor can compare actual versus forecasted numbers.

;What must an auditor have in order to discuss issues relating to a predecessor auditor's work? If issues relating to predecessor auditor's work on previous F/S come up during the current audit, Auditor must have client's permission to discuss the issue.

;What questions must an auditor ask with respect to procedures carried out by assistants? Were they adequately performed? (Review the working papers) Are the results consistent with the audit report?

;How is audit strategy mapped out? Auditor determines what the reporting objectives are. Auditor determines the scope of the audit.

;What are the foundations of Generally Accepted Audit Standards (GAAS)? Materiality and Audit Risk

;What are the General Standards for auditing? Training and Proficiency (Education and Audit Experience) Independence Due Professional Care (TIP)

;Describe the key components of maintaining auditor independence. Auditor must be independent in fact and appearance. Honesty. No direct financial interest. No indirect material financial interest.

;Describe Due Professional Care. Technical abilities mirror those held by peers in the profession. Follow GAAS Standards. Obtain a Reasonable Level of Assurance. Maintain Reasonable Level of Skepticism. Supervise Audit Staff. Review judgment at every level.

;List the Standards of Field Work. Planning and Supervision. Internal Control. Evidence (PIE)

;List the Standards of Reporting. Disclosures. Opinion. GAAP. Consistency (DOG-C)

;What should an auditor do prior to accepting an audit engagement? Review the previous financial statements. Speak to third parties. Contact predecessor auditor to evaluate whether engagement should be accepted (must have client permission)

;What questions should be asked by an auditor prior to taking an engagement? Note: must have permission of client or contact predecessor auditor (no permission = no engagement) Why the Auditor Change? Any Serious Discussions with Audit Committee? How is Management Integrity? Disagreements? How was Internal Control? Understand Industry or Be Willing to Learn Consider Scope Limitation - Limited evidence available = no engagement

;What should be included in an audit engagement agreement? Note: must be written Objectives of Engagement Limitations of Engagement Responsibilities of Management - Provide written assertions Responsibilities of Auditor - Limited error/fraud responsibility Expectations of Access to Records Financial Statements (and Disclosures) are Management's Responsibility Compliance with Laws Internal Control

;What is management's responsibility with respect to the financial statements? Management is responsible for financial statements and adequacy of disclosures. Presentation & Disclosure Existence (Tests Overstatements) Rights & Obligations Completeness (Tests Understatements) Valuation & Allocation

;What is the purpose of the Audit Committee? Responsible for Hiring Auditor Oversees Internal Control Must Agree with Auditor on: Responsibility of the Parties, Audit Fee, Timing of the Audit, Audit Plan Acts as Liaison Between Auditor and the Board Auditor Communicates Concerns about: Internal Control Deficiencies, Errors, Fraud, Illegal Activities

;How is Audit Risk calculated? $\text{Inherent Risk} \times \text{Control Risk} \times \text{Detection Risk}$ Risk that material mistakes, errors, omissions, or fraud will result in an inaccurate audit report Based on Auditor Judgment Measured in both Qualitative and Quantitative

;Describe Control Risk Risk that internal control will not detect error or fraud Audit cannot control this.

;Describe Inherent Risk. Which transactions have a higher level of risk? Auditor cannot control

;Describe Detection Risk. Will the auditor fail to detect a material misstatement? Auditor CAN control Do testing at year-end Increase substantive testing Run more effective tests

;What responses should an auditor take based on difference levels of acceptable detection risk (DR)? What type of tests should be performed? Less Acceptable DR = Run More Sub. Tests More Acceptable DR = Run Less Sub. Tests More Sub. Tests (DR down) = Less Audit Risk- ($AR = IR \times CR \times DR$) Less Sub. Tests (DR up) = More Audit Risk- ($AR = IR \times CR \times DR$)

;What are quantitative measurements versus non-quantitative measurements with respect to risk? Quantitative Measurements - Inherent, Control, and Detection Risk can all be measured in terms of percentages Non-Quantitative Measurements - Inherent, Control, and Detection Risk can all be measured in terms of acceptable ranges

;Whose responsibility is it to FIND and PREVENT fraud? It is Management's responsibility.

;What is the auditor's responsibility with respect to fraud and illegal acts? Assess the RISK that such things will lead to material misstatements Design the audit to provide reasonable assurance against fraud, illegal acts that directly and materially affect the f/s Report ALL management fraud to the audit committee (minor fraud by low-level employees not reported to committee) Perform required inquiries and procedures (management inquiries, analytical procedures, discussions with audit personnel about fraud)

;What are the three factors that affect/influence fraud? Fraud is born out of: Incentive Opportunity Rationalization

;What is the difference between fraud and errors? Errors are unintentional, fraud is intentional.

;"What ""red flags"" may indicate higher risk in an audit?" Management compensation tied to stockAggressive financial forecastingFormer auditor disagreed with MgmtRecords not available for auditCurrent audit procedures may need to be reconsidered if red flags exist.

;Describe the characteristics of a Fraud Risk Factor. Has been observed in similar situationsDoes NOT necessarily mean that there is a material weakness in internal controlLeads to an auditor taking action

;What does an examination of internal control accomplish with respect to illegal acts?

Internal control analysis can result in the conclusion that IC is weak, but probably won't identify illegal acts

;What is the purpose of adjusting audit procedures in light of fraud risk factors identified during an audit? Strives to make audit engagement procedures less patterned and predictableRe-evaluates management's application of accounting proceduresFinds and assigns audit personnel with relevant skills in this area

;What should be documented with respect to fraud risk factors in an audit? Any fraud risks identified that could lead to material misstatementAudit procedures performed to assess risksNature of communication made to audit committee and company managementDisclosure to third parties regarding fraud not normally the auditor's responsibilityFraud by management should normally be reported to the audit committee, NOT the SEC.

;What was the effect of the SOX Act of 2002? Created PCAOBDesignates Officer responsibility for internal controlMust disclose significant internal control weaknesses to auditor and audit committeeMust disclose any level of fraud discovered by employees with internal control responsibilities

;What is the Hierarchy of Authoritative Literature? 1. Statements on Auditing Standards (SAS)2. Auditing Interpretations, AICPA Guides & SOPs3. Industry Articles (no authority)

;What quality control activities are undertaken by CPA firms with audit practices? Firm Leadership exhibits quality and leads by example and sets the tone for the organizationFirm should Monitor and document that its policies and procedures are being followedFirm should have Relevant Ethical RequirementsAcceptance and continuance of client engagements should continue to be evaluated for client integrity, auditor competency, and legalityFirm should have competent and ethical personnelFirm engagements are performed, supervised, and reviewed in accordance with professional standards and regulations.

;Which literature governs Compilation services? SSARS - Statements on Standards for Accounting and Review ServicesThese govern reporting for non-public entities only

;What is the independence requirement for Compilations? Independence NOT required for CompilationsNo Internal Control work allowedNo assurance given

;What type of assurance is provided by a Compilation? Compilations are not an assurance service. No assurance is provided.

;What type of assurance is provided by Review services? Reviews provide NEGATIVE assurance.

;What is the independence requirement for a Review? Reviews require independence.No Internal Control work allowedPerforms analytical proceduresNo material indirect financial interest allowedNo immaterial direct financial interest allowed

;For compilations and reviews, what knowledge must a service provider have? Must have an understanding of the client industry.

;What are attestation services? CPA expresses a conclusion about an assertion - Compliance with laws NOT considered a Consulting engagement Independence Required

;What is the independence requirement for consulting services? Independence is not required for consulting services.

;Describe the limitations on Prospective Financial Statements? Report is restricted to specified users. Agreed-upon procedures are implemented.

;What is the majority of an auditor's work in determining an audit opinion? Collection of evidence to support the opinion.

;Of what does audit Evidence consist? Evidence consists of client accounting data and supporting documentation from client or from third parties.

;What is the relationship between Evidence and Detection Risk? Evidence has an inverse relationship with Detection Risk. The one aspect of Audit Risk an auditor can control. Inherent Risk and Control risk are outside of auditor's control. Auditor controls this by through evidence collection and Risk determines (N)ature, (T)iming, (E)xtent of audit procedures.

;Which aspects of Audit Risk can an auditor control? Detection Risk, which is decreased by gathering evidence.

;Which aspects of Audit Risk can an auditor NOT control? Inherent Risk and Control Risk are outside of an auditor's control.

;How does a high level of acceptable Detection Risk affect an audit? Less Evidence collected. Opens door for incremental audit risk - Internal Control should be strong. Business and transactions should be relatively stable and predictable. (N) Less-competent Evidence collected (T) Interim testing acceptable (E) Fewer transactions are verified.

;What should occur when a low level of Detection Risk is acceptable? More Evidence collected (N) More-competent Evidence collected (T) End of year balance testing (E) More transactions are verified

;What are the primary risks in an audit for a typical for-profit company? Auditors are there to verify that Assets & Revenues are not overstated Expense & Liabilities are not understated Exception - if the CPA Exam states that it is a "tax-driven" company, flip them around

;What is the primary constraint on audit evidence? Cost vs. Benefit is a primary constraint.

;What characteristics should audit evidence have? Sufficient (quantity) Appropriate: Relevant & Reliable (Quality)

;How does the quality of audit evidence vary depending on who has provided it? Best evidence: Observation of activity by auditor. 2nd Best: Originates from External Parties and is sent directly to auditor (or failing that, items are generated by third party and provided to auditor by the client, such as a bank statement) Weakest: Oral evidence from management.

;Which documents are the most persuasive and credible? Third party documents are more persuasive and credible than internally-prepared docs Auditor Knowledge = Most Persuasive 3rd Party info given to auditor 3rd Party info given to client Internally-prepared doc

;What are Substantive Procedures? Test substance/amounts/values. They help to reduce the risk of material misstatements. They only test accuracy of f/s and dollar amounts - they don't test internal controls.

;What are the substantive tests that are most often performed? Trace (or Vouch)ReconcileAnalytical ProceduresConfirmationsExamine evidence that supports management assertions.(T.R.A.C.E.)

;When performing audit procedures, what should auditors focus on? Auditors focus first on Balance Sheet Accounts, then associated Income Statement items

;How is Cash audited? Assurance Level is High. Acceptable DR is Low.

;How is A/R audited? If Acceptable DR is High - Negative Confirmation is used - Customer only responds if balance is materially wrong. If Acceptable DR is Low - Positive Confirmation is used - Customer asked to confirm by telling auditor the balance. Corresponding I/S accounts - Revenue

;How is A/P audited? Review purchase orders/InvoicesConfirm with VendorsCorresponding I/S Account – Various Expenses

;How is Inventory audited? Examine purchase agreementsLook at Board MinutesIs Inventory held as collateral?Corresponding I/S Account – COGS

;How are beginning balances audited? Should match last year's ending balance.

;What is the general presumption for auditing Ending Balances? If Beginning Balance, Additions, Subtractions are ok, the Ending Balances should also be ok.

;How is a Statement of Cash Flows audited? Foot all balances – Check the MathTrace Cash Flow items to other F/SCheck classifications - Operating Activities, Investing Activities, Financing Activities

;Under the Indirect Method, what must be disclosed on a Statement of Cash Flows?

Interest PaidIncome Taxes PaidNon-cash TransactionsCash and Cash Equivalents Definitions

;Under the Direct Method, what must be disclosed on a Statement of Cash Flows? Results as if you had used Indirect MethodNon-cash TransactionsCash and Cash Equivalents Definition

;What are Subsequent Events, and what do they require? Subsequent events are events that occur after the Balance Sheet Date, but before the audit report is issued. Auditor needs to make inquiries and assess if they affect the audit report.

;What should occur if the audit report has already been issued and the auditor becomes aware of a situation that was present as of the Balance sheet date (a subsequent event)? If audit report has already been issued and auditor becomes aware of a situation that was present as of the BS date, client should issue a disclosure to F/S users and/or revise the F/S.Regulatory agencies might need to get involved under some circumstances.

;What should an auditor do if they discover they have forgotten to perform a substantive procedure? If auditor discovers that they forgot to perform a substantive procedure, auditor should determine if other substantive procedures performed served as a substitute.Otherwise support for their audit opinion could be jeopardized.

;When are Analytical Procedures required? REQUIRED When planning the audit (preliminary)REQUIRED When reviewing the audit (final)Analytical procedures may be also performed optionally along with the substantive testing.Use of Analytical Procedures in the audit must be documented.

;How do Analytical Procedures assist the auditor? Helps the Auditor:Determine if Management Assertions are reasonableDevelop audit planDevelop some expectations about the F/S and hopefully bring to light any glaring errors on F/S

;What is the focus of Analytical Procedures? Analytical Procedure focus is on dollar amounts (not internal controls) Analyzes Financial Data: Do F/S Make Sense? Comparison of data between years

;How is the Asset Turnover calculated? $\text{Asset Turnover} = \text{Net Sales} / \text{Average Assets}$

;How is the Inventory Turnover calculated? $\text{Inventory Turnover} = \text{COGS} / \text{Average Inventory}$

;How is A.R. Turnover calculated? $\text{A.R. Turnover} = \text{Net Credit Sales} / \text{Average A.R.}$

;How is Gross Margin % calculated? $\text{Gross Margin \%} = \text{Gross Margin} / \text{Sales}$

;What type of testing are ratios? Ratios are Analytical Procedures

;What type of procedure is a Budget vs. Actual comparison? Budget vs. Actual comparisons are Analytical Procedures.

;List Common Types of Analytical Procedures Ratio analysis Budget vs. Actual comparison Comparison of data between years Use of non-financial data to predict expected values for financial data

;How do management assertions affect the audit? Management assertions help the auditor to plan the audit and select substantive tests.

;What assertions do auditors test? Presentation - Cutoff, Classification - Is it in the right period and category? Existence/ Occurrence - Did it happen? Does it exist? Rights & Obligations - Does the company own them? Completeness - Was everything recorded? Valuation - Are they worth the amount at which they are recorded? (PERCV)

;What assertions are tests for transaction classes?

Occurrence Cutoff Classification Completeness Accuracy

;For which assertions are disclosures tested?

Occurrence Completeness Classification Accuracy

;Is testing the validity of direct evidence a basic audit procedure? No, it is an extended procedure. For example, you don't have to take a loan covenant document and go search out that it's a valid loan covenant. Instead, you consider the source – if it's externally prepared, it's more persuasive.

;How are Management Estimates audited? First and foremost, you need to understand management's rationale and methods for developing estimates before you can judge reasonableness. Next, Auditor should formulate their own opinion on what a good estimate should be and compare it. Finally, determine if subsequent events affect the estimate.

;Whose property are audit documentation (audit workpapers)? In what form must they be?

Audit workpapers are the property of the auditor. They can be paper or electronic. They must include a WRITTEN audit program (either paper or electronic).

;What is the Current File? Information pertaining to the current year's audit.

;What is the Permanent File? Information used for this audit and future audits, which is updated as needed.

;How long must audit workpapers be maintained? Must be kept for 5 years after the audit release date or according to regulations, whichever is longer. Must be kept for 7 years under PCAOB Audit. PCAOB audits also require an Engagement Completion Document

;What is the primary requirement for audit workpapers, besides being written? Any experienced auditor should be able to look at your work and understand what you did.

;How should documents added to work papers be treated? If further documents are added to the work papers after the audit report is issued, it must be documented as to who added them, why they were added, and any affects on the audit report.

;How should documents removed from workpapers be treated? After the audit report is released, the firm has 60 days to subtract from the file. You can still add to the file if you document it, but you cannot delete any information after 60 days. Note – for SEC auditors, the PCAOB only allows deletions up to 45 days after issuance of the audit report.

;What does auditing internal control in a company's IT environment accomplish? Plan the rest of audit - Shorter audit trails that may expire, Less documentation
Assess the level of Control Risk - Unauthorized access to systems or data is more difficult to catch
Systems access controls adds another layer to separation of duties analysis
Focus should be on the general controls, new systems development, current systems changes, and program/data access control or computer ops control

;When is an audit of IT NOT required? Controls are redundant to another department
The system doesn't appear to be reliable and testing controls wouldn't be an efficient use of time
Costs exceed benefit

;When can an audit of IT be performed without directly interacting with the system? System isn't complex/complicated
System output is detailed

;What is the role of a Database Administrator? Maintains database
Restricts access
Responsible for IT internal control

;What is the role of a Systems Analyst? Recommends changes or upgrades
Liaison between IT and users

;What is the role of the data Librarian? Responsible for disc storage
Holds system documentation

;What is the benefit of Generalized Audit Software in an audit? Uses computer speed to quickly sort data and files, which leads to a more efficient audit
Compatible with different client IT systems
Extracts evidence from client databases
Tests data without auditor needing to spend time learning the IT system in detail
Client-tailored or commercially produced

;What is a Relational Database? Group of related spreadsheets
Retrieves information through Queries

;What functions are performed by a Data Manipulation Language? Maintains and queries a database
Auditor needs information, so client uses DML to get the information needed

;What functions are performed by a Data Control Language? A Data Control Language controls a database and restricts access to the database.

;What are Check Digits? A numerical character consistently added to a set of numbers. It makes it more difficult for a fraudulent account to be set up or go undetected.

;What is the purpose of a Code Review? A Code Review tests a program's processing logic. Advantageous because auditor gains a greater understanding of the program.

;What is the purpose of a Limit Test? Examines data and looks for reasonableness using upper and lower limits to determine if data fits the correct range. Did anyone score higher than 100%?

;What is the Test Data Method? Auditor processes data with client's computer - fake transactions are used to test program control procedures. Each control needs to only be tested once
Problem with this method - fake data could combine with real data.

;How can Operating Systems Logs be utilized during an audit? Auditor can review logs to see which applications were run and by whom.

;What is the purpose of Access Security Software? Helpful in online environments Restricts computer access - may use encryption.

;How can Library Management Software assist with an audit? Library Management Software logs any changes to system/applications etc.

;How can Embedded Audit Modules in software be utilized in an audit? Assist with audit calculations Enable continuous monitoring in an audit environment that is changing Weakness: requires implementation into the system design- Example: SCARF Collects information based on some criteria and can be analyzed at a later time (necessary because the audit environment is continually changing)

;What is an Audit Hook? An Audit Hook is an application instruction that gives auditor control over the application.

;What is the purpose of Transaction Tagging? Transaction Tagging allows logging of company transactions and activities.

;How do Extended Records assist in audit trail creation? Extended Records add audit data to financial records.

;How does Real Time Processing affect an audit? Destroys prior data when updated aka "Destructive Updating" Requires well-documented Audit Trail

;What is the risk of auditing System outputs versus Application outputs? If the auditor only audits the outputs of a computer system and doesn't also audit the software applications, an error in the applications could be missed.

;What is a Compiler? Software that translates source program (similar to English) into a language that the computer can understand

;How is Parallel Simulation utilized during an audit? Client data is processed using Generalized Audit Software (GAS) Sample size can be expanded without significantly increasing the audit cost GAS output compared to client output

;If internal control is poor and a company's accounting practices are sloppy, which risk is higher?
Control risk increases with poor internal control and sloppy accounting practice.

;If internal control is poor, what is the effect on the audit? Auditor will need to perform more testing and dig deeper into accounts in order to arrive at an opinion regarding the financial statements.

;For what does internal control provide reasonable assurance? Internal control provides reasonable assurance that: Material misstatements will be prevented Reliability/integrity of financial statements will be preserved Assets are protected against misuse

;What is required in an examination of internal control under SOX? CEO/CFO must disclose I/C deficiencies Management must provide assessment of I/C Management must certify F/S

;What is the relationship between internal control and Substantive Testing? Better internal control results in LESS substantive testing Poor internal control leads to MORE substantive testing

;What are the three objectives of internal control? Reliability of Financial Reporting Operational Efficiency/Effectiveness Compliance with Law and Regulatory

;What are the five components of internal control? Control Activities Risk Assessment Information and Communications Monitoring Control Environment (C.R.I.M.E.)

;What is the purpose for a control environment assessment? Sets tone for the entire company

;What are the components of the Control Environment? Integrity/Ethics of Management
Competence of Management
Organizational Structure
Human Resource Policies
Assignment of Authority/Responsibility
Management's Style (riskier with a dominant/aggressive individual)
Board/Audit Committee involvement

;What does an auditor's assessment of Detection Risk determine? Detection Risk determines nature, timing, and extent of audit procedures.

;What determines the acceptable level of Detection Risk? Risk of material misstatement determines acceptable level of Detection Risk

;What items could increase the risk of material misstatement? Rapid growth in the company.
The methods management uses to identify risk, estimate its significance and assess the likelihood of occurrence
Major changes to operations, personnel, systems, IT, products, corporate organization, and foreign operations.

;What happens when Control Risk is assessed to be at the maximum level? No internal control testing is performed.
All audit procedures are increased in intensity to compensate for increased risk.

;What happens when Control Risk is below the maximum level? Auditor tests internal controls.
Auditor evaluates Control Risk based on tests
Auditor adjusts substantive tests accordingly:
Weaker I/C = More substantive tests
Stronger I/C = Less substantive tests

;Describe some common examples of Control Activities. Performance Reviews
Information Processing
Physical Controls
Segregation of Duties

;What should an auditor understand with respect to Information and Communication on an audit? Understand Client's:
Major transaction classes
Transaction initiation
Support records/documents
Transaction processing
F/S internal reporting process
F/S external communication process

;How must an auditor document understanding of internal control? Through written documentation such as an internal control memo.
Other types of documentation:
Engagement-specific flowcharts
an questionnaires

;What questions should be asked to determine the risk of material misstatement? Were all transactions recorded?
Were they timely?
Measured appropriately?
Recorded in correct period?
Presented and disclosed properly?
Did Management communicate their responsibilities?

;What is the purpose of testing internal controls? Auditor needs reasonable assurance that controls are functioning as designed and effective
I/C Testing should be strong as (I/ROn) so that nothing gets past them
Inquiry – Interview company personnel
Re-performance – Can it be replicated?
Observation – Watch the control be applied
Inspection – Dig into the details/documents
If results are as expected, substantive procedures do not need to be adjusted

;When can controls tested by an auditor in a prior year be used in the current year's audit assessment? Controls tested by auditor in a prior year can be used in the current year's audit assuming they are re-tested every third year
Exception: If the control has changed since the last audit

;What happens if internal controls are deficient? Control Risk increases
Scope of substantive procedures increases
Detection Risk decreases
Material Weakness - Reasonable possibility that a material misstatement in F/S would not be found, more than a remote chance of occurrence

;What is a Material Weakness? Reasonable possibility exists that a material misstatement in F/S would not be found, and has more than a remote chance of occurrence.

;What does Tracing test? Tests Completeness Starts with source document and traces forward to the journal entry.

;What does Vouching test? Tests Existence Starts with an entry and searches for a voucher or source document to support the entry.

;What activities represent Segregation of Duties? Non-compatible duties performed by separate individuals, such as: Authorization of asset disbursement vs. Recording of Assets vs. Custody of assets If supporting audit evidence doesn't exist, use Observation and Inquiry Accounting should be segregated from Production

;With respect to signing checks, how are duties segregated? Employees who prepare vouchers/invoices should not also have the authority to SIGN CHECKS Tip – Remember this as an underlying theme with Segregation of Duties – authority to make a payment should not also lie in the hands of those creating invoices/vouchers. Why? People commit fraud by setting up fake companies and basically paying themselves

;With respect to custody of assets, how should duties be segregated? Employees who have custody of assets should not also RECORD those assets Someone in charge of petty cash should not also control the petty cash records Treasury Department (custodians) should NOT have record keeping duties They control assets and should not be able to adjust any recording of those assets

;What are the limitation on control activities? Controls can't stop collusion or bad judgment Management can override controls Cost vs. Benefit relationship of I/C

;What is required if a Material Weakness is identified? A written report to management is required. Report declaring that no material weaknesses were found is allowed Previous weaknesses reported that still exist should be reported again Should be reported no later than 60 days after audit report release date If one or more material weaknesses is uncorrected at year-end, an Adverse Opinion on internal control must be given

;What is the effect of a Significant Deficiency? What is it? A significant deficiency adversely affects a company's ability to report in the financial statements according to GAAP. A significant deficiency is a "more than a remote likelihood" of material misstatement by "more than an inconsequential amount"

;What must occur if a Significant Deficiency is identified? If a Significant Deficiency is identified, a written report to management required Report declaring that no significant deficiencies is not allowed Previous deficiencies reported that still exist should be reported again Should be reported no later than 60 days after the audit report release date

;What is a Control Deficiency? A control is not operating as intended Written report to management not required

;What must an auditor ask if using the work of third parties? Are the competent? Are the objective?

;What must an auditor understand with respect to internal auditors? Auditor needs to understand the role of Internal Auditors within the organization because their work affects the audit plan Responsibility for judgments about materiality or appropriateness of entries or estimates cannot be shared with third parties like Internal Auditors Internal Auditors should be

asked to do some of the legwork like preparing schedules or running reports They should not be asked to make any decisions or judgments

;Who created the International Auditing Standards? The International Auditing and Assurance Standards Board (IAASB) Member of the International Federation of Accountants (IFAC)

;For whom were IAASB International Auditing Standards created? IAASB standards are for countries that don't have their own standards and help set the tone for the rest of the members who do have their own standards (AICPA) IAASB doesn't override member standards

;What financial approach is used under IAASB audit standards? IAASB standards are based on a risk assessment approach

;How do IAASB audit standards compare to US audit standards? IAASB = No Internal Control audits IAASB = No Referencing another Audit Firm IAASB = Less detailed documentation IAASB = Required: obtain written fraud assessment IAASB = Required: location of auditor's home office

;What are International Ethical Standards? Standards set by International Ethics Standards Board for Accountants (IESBA) Code of Ethics for Professional Accountants - Similar to AICPA Code of Professional Conduct

;Which groups are covered under the three sections of the International Ethical Standards?

A) Covers all accountants B) Covers Public accountants C) Covers accountants in a business environment

;What are the requirements for all accountants under the International Ethical Standards?

Accountants should have Integrity Accountants should be Objective Accountants should have Competence Accountants should exercise Due Care Accountants should maintain Confidentiality Accountants should act Professionally

;What questions should public accountants pose to themselves under the International Ethical Standards? What are the threats/safeguards? Does this new client threaten our ethics? What are the conflicts of interest? What are the threats/safeguards for offering a second opinion? What are the threats/safeguards for receiving commissions or contingent fees? Is our marketing truthful? What are the threats/safeguards for receiving client gifts? What are the threats/safeguards to objectivity

;What engagements are covered by the AICPA Code of Professional Conduct? Covers all professional engagements and is the minimum standard of conduct Member should additionally follow specific standards for a specific engagement

;What must an accountant have under the AICPA Code of Professional Conduct?

Integrity Objectivity No Conflicts of Interest No known misrepresentations of facts No outsourcing of judgment

;What are the ramifications of threats and safeguards to independence? Safeguards > Threats = Independence Threats > Safeguards = No Independence

;What are the threats to independence? Self-Review (Auditing own work) Advocate of the Client Adverse Interest (Lawsuit against Client) Too familiar with Client – could impair the appearance of Independence to public Undue influence on Client - On BOD, exception being an Honorary board position

;What are the Safeguards to independence? Offset the threats Safeguards are created by Legislation (SOX), Client (Audit Committee), Accounting Firm (Policies)

;What are the characteristics of a Covered Member? On the engagement team, have Significant influence on Audit, such as: Reviewing Partner Managing Partner in CPA Firm Firm

Personnel who does more than 10 hours of non-attest work (Income Taxes) Partner sharing office with another Partner who oversees an engagement Financial Interest in Client by Covered Member (Auditor on Engagement)

;What are the requirements for a Covered Member? No direct financial interest No

Material indirect financial interest Firm personnel who are not Covered Members cannot own more than 5% of stock Covered Member's immediate family cannot own more than 5% of stock or be employed in Key positions. If Covered member is aware of this, it will impair independence. Cannot make management decisions. All requirements apply during the period of the professional engagement, and as long as they are a client.

;What happens when a Covered Member disagrees with a Supervisor? If Supervisor's position is still GAAP/GAAS, defer to Supervisor If Supervisor's position is not GAAP/GAAS, report to higher levels of management If management ignores you, consider leaving the firm

;When is independence required? Audit Review Attestation Engagement

;What are the requirements for Non-attest engagements? Agreement must be in writing. Independence not required - Must state if you are not independent Applicable engagements: Consulting, Compilation

;Which standards apply to consulting engagements? Consulting engagements are covered by Statements on Standards for Consulting Services (SSCS) Requirements: Competence, Due Care, Planning, Supervision, Obtain Sufficient Data, Must Serve Client Interest, Must have written or oral agreement, must communicate with client.

;List some common consulting engagements. Advisory Services Transaction Services Management Consulting Implementation Services

;What is the rule concerning contingent fees for a covered member? Not allowed if Member also performs services where independence is required Commissions or referral fees for Covered Members are not allowed Example – Audit firm gets a commission for recommending to Client that they implement a new A/P System... NOT Allowed if a firm performing non-attest work doesn't also perform Covered Member services (aka – Independence not required), then Firm can get a commission on referring products/services, but they must disclose to the Client Tax Preparation - Payment according to refund amount is disallowed

;When are contingent fees allowed? When fees are structured relative to judicial proceedings. Example: IRS audit, or filing an amended tax return subject to tax case with a different taxpayer.

;How should recommendations and suggestions by a covered member to a client be handled? Client must carry them out - covered member cannot perform management functions. Client must assign someone of competence to oversee the non-attest engagement and CPA must be satisfied that this has occurred.

;What are the requirements for Personal Financial Planning Engagements? Must have definite objectives Must have specific procedures planned Must have a basis for recommendations Must have recommendations communicated Must have action steps to implement

;When is a GAAP departure appropriate? Departure from GAAP is appropriate if GAAP would cause F/S to be misleading, then it must be explained/disclosed.

;When may a covered member disclose confidential information? Member may disclose confidential info when client isn't following GAAP OR if they receive a subpoena – CPAs are not Attorneys, so there is no CPA-Client privilege

;What is the effect of not returning all client-provided documents upon request? This is an act discreditable. You MUST return all documents the client gives you even if they don't pay their bill. If you create a document, however, like a work paper, you are not required to give the client a copy of papers you created if they haven't paid their bill. They are the firm's work papers, but are still confidential!

;What are the rules with respect to CPA firm names? CPA firm names must not be misleading. If partner dies, remaining partner has two years to change name if partnership dissolved. If partner dies and more than one partner still remains (i.e. 1 dies and you still have 2 or more partners...you don't need to change the name) All Partners/Shareholders must be members of the AICPA in order to hold themselves out as members of the AICPA. Non-CPA's can be owners, but 2/3 of Ownership must be CPAs. Non-CPA owner must not be involved with the accounting, and is still bound by AICPA code of conduct, must maintain CPE requirements and have Bachelor's degree.

;What is the consequence of disclosing CPA exam material post-1996? It is an Act Discreditable.

;What are the consequences for a CPA who commits an Act Discreditable? Licenses are granted at the State level. If State revokes certificate, AICPA Ban. Felony Conviction, AICPA Ban. Prepares Fraudulent Tax Return, AICPA Ban. Intentionally failing to file return, AICPA Ban. SEC can get involved with discipline

;What are the functions of the PCAOB? Monitors CPA Firms who audit SEC clients - All SEC Audit firms must register. Issues standards for firms to follow - usually stricter than AICPA standards

;When is independence impaired under PCAOB standards? If Client pays a contingent fee (i.e. based on outcome) With Marketing or Planning engagements Aggressive Tax Strategies Firm does tax work for Client employee involved with audit oversight or their family

;Who must approve non-audit work performed by a firm for a client? Client Audit Committee must approve non-audit work performed by Firm. Firm must disclose any potential independence issues to Audit Committee

;Which organization is in charge of determining if federal funds are being misappropriated? GAO - Government Accountability Office

;What rules must auditors follow for governmental audits? Auditors must follow both GAAS and GAS – aka the “Yellow Book” Materiality threshold is usually lower. More detail is required on working papers. More stringent CPE rules and requirements - 24 hours of continuing education must be related to governmental auditing every 2 years. Compliance with Regulations is a requirement of the Audit Report

;What is Audit Sampling? Taking part of a population, subjecting it to audit procedures, projecting results to a population

;What are the characteristics of Statistical Sampling? Based on formulas. Helps find an appropriate audit sample. Helps evaluate evidence obtained. Helps evaluate results and quantify Sampling Risk

;What are the characteristics of Non-Statistical Sampling? Based on human decision Equally acceptable as Statistical Sampling

;What are the characteristics of Substantive Tests? Variable sampling Probability proportionate to size sampling

;What type of sampling are Control Tests? Attribute Sampling

;What is Sampling Risk? Risk that your sample isn't representative of population Can happen even if audit is done properly

;What is the risk of assessing Control Risk too high? A risk of Control Testing - Auditor works to make Control Risk lower More substantive tests - Sample overstates Control Risk, Leads to an under-reliance on internal control, over-testing, and overall audit inefficiency Audit ends up being effective (correct result), but you do more work

;What is the risk of assessing Control Risk too low? A risk of Control Testing - Complement to Confidence Level Inverse relationship to Sample Size Higher accepted risk of assessing Control Risk too low = Smaller Sample Lower accepted risk of assessing Control Risk too low = Larger Sample

;What are the risks if the auditor concludes controls are operating effectively based on the sample and Control Risk is set too low? Leads to higher Detection Risk - Fewer substantive tests Sample understates Control Risk This error leads to over-reliance on internal control, undertesting, and overall audit ineffectiveness. Does NOT necessarily mean that the F/S are materially misstated – it does mean that if there is one, you are less likely to find it

;What is the risk of Incorrect Acceptance? A risk of Substantive Testing - Auditor accepts a balance as fairly stated, when in fact it is not fairly stated Hurts audit effectiveness Wrong conclusion reached Efficient, but not effective

;What is the risk of Incorrect Rejection? A risk of Substantive Testing - Auditor rejects balance as fairly stated when in fact it is fairly stated Hurts audit efficiency Wrong recommendations given Effective, but not efficient

;What is Non-Sampling Risk? Risk of human (auditor) missing an error Also called exception, error or deviation.

;How does Sampling Risk compare to Non-Sampling Risk? Sampling Risk deals with the chance that your audit sample is flawed Non-Sampling risk deals with the chance that your human decisions/conclusions are flawed

;What is Attribute Sampling? Looking at Control Procedures - Were invoices approved when paid? Errors are stated in terms of %, not dollar amounts For example, 5 invoices out of 100 were not properly paid. Error rate is 5% Hint: If you see Error Rate on the Exam, they are referring to Attribute Sampling.

;How do you determine if Control Procedures are operating properly or not operating properly?

Control Procedures are either operating properly or they are not operating properly – based on Error Rate and the tolerance you have for errors

;What is the Tolerable Rate? Error rate in population that you are willing to accept/tolerate Inverse relationship to Sample Size Higher Tolerable Rate = Smaller Sample Lower Tolerable Rate = Larger Sample If you're willing to accept a higher probability that errors exist, there is less pressure on the sample

;What is the Expected Population Error Rate? What Error Rate are you expecting? - Judgment call, based on experience
 Direct relationship to Sample Size
 More errors = Larger Sample
 Less errors = Smaller Sample

;What is the basic premise of Attribute Sampling? Attribute in the sample gives information about the entire audit population
 Used to estimate Internal Control error rate

;For what is the Expected Population Deviation (error) Rate used? Used to determine initial level of Control Risk

;What is the Allowable Risk of Overreliance? Risk of Assessing Control Risk too low
 Gives you the Sampling Risk

;When is Attribute sampling used? Attribute sampling is only useful when there is documented evidence (an audit trail) to test
 Use when the existence of an error needs to be verified or debunked

;What is Classic Variable Sampling? Testing for a dollar amount
 Value in sample gives information about value in entire population.

;What functions are used in conjunction with Classic Variable Sampling? Mean Per Unit = Sample Average x Number in Population
 Stratification - Decreases effect of variance in population and reduces sample size

;What are the characteristics of Probability Proportionate to Size sampling? A form of Variable Sampling
 Does NOT use Standard Deviation
 Auditor focuses on a dollar amount
 Larger or more valuable items get picked more often as part of the sample

;What is Projected Misstatement? Misstatement found in sample – have to project it to remainder of population

;How does Probability Proportionate to Size sampling compare to Variable sampling?
 PPS: Easier to use, Results in a stratified (homogenous) sample, Results in a smaller sample size to audit, Easy to design
 Classic Variable Sampling: Easy to expand sample size, Selecting zero and negative balances easy

;What factors affect sample size? Tolerable rate for error - Inverse relationship with sample size
 Risk of assessing Control Risk too low - Inverse relationship with sample size
 Expected population error rate - Direct relationship with sample size
 Population size does NOT affect the sample size - as population is larger, sample size doesn't grow.

;What is the formula for Audit Sampling? $SER + ASR < TER$
 SER = Sample Error Rate
 ASR = Allowance for Sampling Risk
 TER = Tolerable Error Rate

;What is Allowance for Sampling Risk? The amount that you add to the Sampling Error Rate to get some cushion for your sample.
 As high as you think the population error rate could go based on experience.

;What is the Tolerable Error Rate? The amount of error rate that you can accept - If population error rate is less than TER, then accept the Control as effective
 If population error rate is more than TER, do more testing to get SER lower or conclude control isn't effective. Do more substantive testing

;What are the steps to develop a sampling plan? Determine Test Objective - for example, have sales shipments been billed?
 Define Population and Deviation - take a sample of shipping document, trace forward to see if billed
 Determine Sample Size based on tolerable rate for error, risk of assessing Control Risk too low, and expected population error rate.
 Select Sampling Technique

;After a Sampling Plan is developed, what are the steps in sampling? Perform the Sampling Plan
Evaluate Results
Document Results

;What is Systematic Sampling? "Every certain # of a population is selected
Population needs to be randomly ordered
Primary advantage is that population doesn't require pre-numbering"

;What is Sequential Sampling? "Also called ""Stop or Go"" sampling
Each audit step determines the next step"

;What is Discovery Sampling? Audit is testing an area that is so crucial, then zero population errors can be tolerated
Any phony employees on payroll?

;How does Block Sampling compare to other sampling methods? Easy to implement, but is the worst method of sampling.

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