

Personal financial planning -> only development of strategies and recommendations to define and achieve financial goals

- Includes assisting in decision-making, monitoring progress, and updating/revising recommendations
- procedures from client's goals, financial position, available resources, materiality & cost-benefit, and external factors
- * Excludes *non-planning* Compilation of statements, tax Compliance (tax returns) and advice/consulting, tax projections

Implementation engagement -> *separate* from basic fin. planning, which is just deciding on goals & how to achieve

- whereby CPA assists client in *taking action/carrying out* the just-developed financial plan (specific, detailed actions)

Consulting SMRY: should document CPA's understanding of scope & nature of engagement (engage letter to client)

- > everything in writing: cover own ass as to what's being provided & what client should expect (reasonable estimates)

Engagement Planning, Understanding of Client & Assessing Risks

Assertions by Management's "Fair Presentation" of the statements for Transactions, Balances, and Disclosures

* Occurrence * Existence * Rights/Obligations * Completeness * Accuracy * Valuation/Allocation * Cutoff * Classification and * Understandability (of disclosures/notes)

!* **Planning considers relevant assertions** for different areas of the audit

Audit Risk = Inherent Risk * Control Risk * Detection Risk = Risk of Material Misstatements & Risk of Failing to Detect Mst

- 1) Inherent Risk -> likelihood/possibility of MMS *assuming no* Internal Control (or MMS *before* considering IC)
 - depends on Client's biz *Characteristics & Environment*; as well as *Nature* of the item (e.g. complex/estimates)
 - *IR Assessed by* analytical procedures, auditing knowledge, and information about the company & industry
- 2) Control Risk -> likelihood that a MMS *will not* be Prevented or Detected on a timely basis by client's Internal Control
 - *CR Assessed by* evaluating the Results of the Tests of Controls
- 3) Detection Risk -> likelihood that audit procedures will improperly conclude that no MMS exists
 - DR is ****controllable by the auditors**** -> DR is *Restricted by* Substantive Procedures

Materiality -> omission or misstatement *capable of influencing Users* decisions (nonaudits: a *reasonable person*)

- OK to have *multiple* Materiality levels for each statement -> then *Apportion* among accounts (Tolerable Misstatement)
 - Planning stage's materiality will differ from later Evaluation, where auditor judges if actual misstatements are material
- !* Managerial Fraud is *always* material

Responsibilities for Detecting Errors and Fraud (False or Misappropriated)

- **Detection for Errors & Direct-effect Fraud** -> assess risk of MS, then design to get reasonable assurance on detecting MMS

1. Direct Effects – when violation has a Material & Direct effect on Statement amounts (e.g., tax penalties -> **Adj. Entries**)

- > like normal: *provide reasonable assurance* of detecting MMS

2. Indirect effects – *neither* material nor direct effect on statement amounts (e.g., price fixing, antitrust -> **note disclosure**)

- > *only if* specific info that suggests potential Fraud-Material Indirect effects, **apply procedures to determine occurrence**

- **Reporting Responsibility** - modify report if departure/scope limitations; report to Audit Committee unless inconsequential

- * if government standards-audit, consider notifying others
- * must report in other situations (successor, subpoena,...)

- **Potentially Illegal Acts** -> inquire of higher-up mgmt. (not involved); if *unsatisfactory* information, should *investigate...*

* Consult client's Legal Counsel * examine source docs, determine if properly authorized transaction, if any other trnsacs

- **Probable Illegality suspected from Auditor's Investigation**

- > consider effect on statements, implications on the audit (e.g., mgmt's representations), communicate to AudComm.

- > consider *Modification of Report*: e.g., lack of disclosure = departure; Scope Limitations by client or *circumstances*

Auditors' Consideration of Fraud -> *Staff Discussions* to ID risks * *Obtain Information* identify risks (even analytical results)

* *Identify Risks* that may result in fraud MMS * *Assess Identified Risks after considering Fraud Programs & Controls*

* *Respond to Assessment Results* (e.g., adjust audit staff or procedures; *always consider Mgmt Override of Controls*)

* *Evaluate Audit Evidence* throughout audit for risks of fraud & respond to potential fraudulent misstatements

- * *Communicate about All Fraud* to Mgmt, to Audit Committee if mgmt. fraud, all material fraud to both; sig. deficiencies
- * *Document Entire Consideration of Fraud* taken by auditors; improper revenue recognition *presumed* as fraud risk

- **3 General Conditions for Fraud by Individuals** -> Incentive/Pressure, Opportunity, and Attitude/Rationalization
- **Analytical Procedures for Revenue accounts** -> should be done to identify unusual/unexpected relationships w/ revenue
- **Responses for Mgmt Override** -> *Test* appropriateness of *Journal entries* and adjustments, *Review Estimates* for bias, and *Evaluate* rationale for *significant unusual transactions*
- **Establish Understanding with Audit Committee** for other non-fraud communications

Client Acceptance

- must have policies on whether to Accept a New client & to Continue or Terminate existing relationship (avoid trouble)

Before acceptance/communicating with predecessor auditors -> initiation is the responsibility of the new/successor

- If potential client limits or blocks communication, Inquire Reasons why & Consider Implications of accepting or not
- Inquiries: mgmt's Integrity; any Disagreements with mgmt.; Communications to AudCom; potential Reasons for change

Establish understanding with client about audit services (usually via *Engagement Letter*; signed and returned)

1. engagement's Objectives
 2. Mgmt's Responsibilities for IC, legal compliance, scope (records), correcting MMS entries
 3. Auditors' Responsibilities for performing per GAAS, communicating to AudCom of any significant deficiencies
 4. audit Limitations -> only Reasonable assurance, possible Undetected MMS, if unable, may disclaim or not issue a report
- * Optional: specifics of audit, predecessor communication, fees/billing, any liability limitations, working papers sharing

Audit Evidence -> AIS, source documents, verifying computations, written representations, physical evidence of tangibles

- * 3rd party representations *requested by client* to send directly to auditors
- * Oral representations only *starting points*
- * *Client Reprstn Letter* (end of audit): all info made avail, complete & per GAAP, IC responsibility, disclosures, suggested adj. entries *not made not material*

Audit Planning

- **Preliminary activities:** determine if client relationship is appropriate & evaluate auditors' ethical & Indy compliance
- **Develop Overall Strategy:** determine reporting objectives (dates/deadlines), characteristics affecting scope (accounting policies), other factors affecting audit like materiality levels, high-risk areas (helps determine the necessary resources)
- **Develop & Document Audit Plan:** description of the procedures needed to achieve an acceptable audit risk level
 - * e.g., risk assessment, tests control/substantive for all items, and others like comm. with customers, lawyers, etc.
- **Develop Audit Program:** *implements* audit Plan via (**Int. Control**) **Systems & Substantive procedures**
 - * Systems: understand AIS *major* Transaction cycles, document, test controls, to determine extent of Substantive
 - * Substantive: usually first B/S accounts (*indirect*) then Rev/Exp/Notes; *Direct IS* verification via Indy computations
- **Timing of Procedures:** flexible; usually at interim & updated until year-end; must coordinate timing for tricky/risky areas
 - * also consider if *worth it* to do interim rather than only year-end: costly? Enough AIS info? Low assessed risks?
- **Understanding of Client & Environment:** i.e. **risk assessment procedures**; inquiries, analytical, observation, inspections
 - * **Recommended Second communication with predecessor auditors** of new client to review their working papers
 - *opening balances*, consistency of GAAP, their planning, consideration of IC, tests results, significant matters
 - * **Re-audits** necessary when predecessor *refuses* to *reissue* audit report for previous year(s), which is necessary, so
 - > successor should request old working papers (if predecessor allows) & perform extra procedures for assurance
- **Supervision of Audit Staff:** determine if work adequately performed & evaluate if results are consistent with audit report
 - * should document staff disagreements of opinion & basis for resolving such differences
- **Assess Risks of MMS & Design Further Audit Procedures**
 - * identify & assess RMMS at *both* the statements-level & relevant assertion-level for transacts, accts, disclosures
 - * how risks can misstate at assertion-level; if *magnitude* could cause MMS; if special attn. req'd; if risk for fraud
 - * design substantive procedures & tests of controls (evidence whether controls are operating effectively)

Audit Procedures -> **Tests of Controls** (IC operating effectiveness) & **Substantive** (two types; to restrict detection risk)

Substantive to detect MMS of relevant assertions -> **Analytical Procedures & Tests of Details** (three detail types)

- * Tests of Details of (1) *Account balances*, ending; (2) *Transactions*, properly recorded; and (3) *Disclosures*, appropriate
- !* After year-end procedures provide greater assurance because misstatements may arise *after* interim period

Analytical Procedures – to determine unusual/unexpected relationships that may require more investigation

- e.g., trend analyses, ratio analysis, reasonableness tests (like uses averages to estimate total revenue/expenses)
- **Process** * Develop expectations * determine levels of acceptable differences * compare results vs. expectations
 - * Investigate and *Evaluate* if indicative of MMS -> reconsider expectations, ask mgmt., expand testing, more evidence
- **Timing** -> required during *Planning & Overall Final Review*; *optional usage as substantive procedure*
- **Extent of procedure** -> depends; only effective when *source data* is reliable & precise techniques (monthly data better)

Evidence for Estimates, FVs, and Related Party Transactions

- Estimates & FV *subjective*, so must *Understand & Test* Mgmt's *Process & Reasonableness*, do Indy estimates, consistent?
 - * review subsequent events/transactions to corroborate; assumptions appropriate & reasonable?; specialists
- Related Parties -> determine if any *business purpose* of significant & unusual RP transactions; adequacy of disclosures
 - * should *maintain list of client's related parties* & keep lookout; update in future engagements

Working Papers -> property of auditors: main support of GAAS-compliance & report opinion; evidence, procedures, etc.

Quality Control Systems for CPAs & Firms (via SoQCS)

- required for reasonable assurance that Firm/Staff comply with appropriate req'ts & partners issue appropriate reports
- SQCS *explanatory material* is *not* a professional requirement

Firm Documentation: QC policies/procedures; evidence of QC elements; *should* communicate to staff *somehow*

6 QC Elements: factors essential to firm QC system & compliance with SQCS

- **Leadership responsibilities:** QC starts from the top; policies should communicate compliance w/ appropriate stds/reports
- **Relevant ethical req'ts:** reasonable assurance of compliance w/ ethics; at least *yearly written confirmation* from staff
- **Accepting/continuing Clients & specific engagements:** client integrity, firm competence, all requirements compliance
- **Human Resources:** that staff is sufficient, competent, and ethical; e.g., recruiting, evaluation, assignment, CPE, promotions
- **Engagement performance:** supervision & review responsibilities; safeguarding & access to engagement documentation
 - * specifics on controls over documentation * policies on the use of specialized consultants
 - * documenting, resolving, and implementation from differences of opinion; **no report issue until diff resolved**
 - * *when to perform an **Engagement QC Review*** of own work; what to review, document, etc.
- **Monitoring** for QC policies-compliance, operating effectiveness, relevance, adequate, etc.
 - * identify deficiencies & consider magnitude/implications to QC; annual communication of mon. results to leaders

Peer Review required for CPAs in public practice w/ reporting responsibilities (2 types, depending if firm audits or not)

- **System Review** tries to understand the Firm's *Quality Control* (via manuals, staff inquiries, and sample of engagements)
- **Engagement Review** *only for* non-audit CPA/firms (but includes other attest); *more restricted, so **limited assurance***
 - samples accounting work & company documentation to see whether Firm's reports and procedures were appropriate

!* Grading * **System:** Pass, Pass w/ deficiencies, or Fail * **Engagement:** *only two*, Pass or Pass w/ deficiencies

Internal Control Concepts

- a process; reasonable assurance 1) Reliable reporting 2) Operating effectiveness 3) Legal & regulatory compliance
- **Relevant Controls** to the Audit: *limited* to those affecting *reliability of Financial Reporting*; so not all controls are assessed
 - * **however** non-reporting controls can *become relevant if used by auditors*; e.g., hiring of salespeople if Analytical
- **Five Components of Internal Control** (1) *Control Environment:* "tone" of org: ethics, HR, competence, mgmt, structure
 - (2) *Risk Assessment:* Identification, Analysis, and Management of Risks re: statement preparation (new/changes)
 - (3) *Control Activities:* policies to mitigate risks against reporting (segregation, physical, processing, performance reviews)
 - (4) *Info Communication:* AIS recording, processing, summaries, reporting -> good statements; comm. responsibilities
 - (5) *Monitoring:* assess quality of IC; *Ongoing activities* (integrated), *Separate evals* (int. audit), or *Combination*
- **IC Limits:** Human Judgment; Breakdowns (Human Failures); Collusion; Mgmt. Override; Cost Controls; "Tone" Not Perfect
- **Assertions & Control Approach:** *first* determine each item's Relevant Assertions, **then consider the related controls**

Foreign Corrupt Practices Act -> for SEC-registered companies: requires *strong* Internal Acctg Control & accurate records

- SOX** (1) Officers responsible for maintaining effective IC; requires CEO, CFO to disclose sig. deficiencies to AudCom, auditors
- (2) Mgmt must *acknowledge* responsibility for establishing adequate IC over reporting & assess effectiveness of IC
 - (3) Mgmt must *certify* that reports filed with SEC comply with securities laws & fairly present condition & Op. results

Obtain Understanding of client, environment, IC -> document IC & perform *Risk Assessment procedures* (IC RMMS)

* inquiries, observing application of controls, inspection of records, tracing transactions, and re-performance

!* understanding determines whether controls are *Implemented* (whereas *Effectiveness* assessed by *Tests of Controls*)

Required Levels of Understanding for IC Components

- 1) Control Environment – Board & Mgmt's *Attitude, Awareness, and Action* (*substance*; what really matters to them)
- 2) Risk Assessment – *How Mgmt considers risks relevant to reporting* & decides mitigation-actions (how ID, judge significance)
- 3) Control Activities – understand the activities *relevant to planning* the audit (usually don't have to understand *all* activities)
- 4) Info Communication – knowledge of AIS to understand (1) major transaction classes, (2) initiation of said transactions, (3) available acctg records & support, (4) manner of processing, (5) reporting process, (6) means of comm responsibilities
- 5) Monitoring – Major types of activities *over fin. Reporting* & how activities are used to *initiate* corrective actions

Risk Assessment: Tests of Controls -> necessary whenever Risk Assessment *relies upon an assumption* of Op. Effectiveness

- *happening upon* evidence of Control Effectiveness *during Understanding* (essentially a concurrent test of control)

- maybe eliminates assumption of effectiveness? So auditors can reduce/eliminate planned tests of controls???

Decision-tables: matches IC *Conditions* to different *Actions*, depending on the answers (eg, whether to perform tests or not)

Assess Risks of MMS & Design Further Audit Procedures

-> based *only* on evidence on the *design* of Controls from above => relate risks; consider magnitude & *likelihood* of MMS

- *Likelihood* of risks resulting in MMS deduced by auditor based on the specific Controls at issue (judgment) & the design

* so assessment can have an *expectation of operating effectiveness* when low likelihood of MMS if Op. effectiveness

Further procedures affected by judgment on *cost-effectiveness* depending on whether expectation if controls Op. Effectively

- usually Tests of Controls results affects necessary Substantive (*tests of details* to support assertions/detect assert. MMS)

* *Dual purpose test* when both are performed *simultaneously*

Tests of Controls -> NOT always required; usually yes, but depends

- required if *Expectation that Controls Operate Effectively* **OR** when Substantive-*only* is not sufficient for evidence

- so if Controls appear weak/poorly designed & only doing Substantive will suffice, then NO Tests of Controls needed

* i.e. Why waste time testing controls that auditors judged to be inadequate? Instead focus on substantiating *results*

* **Inquiries** * **Inspection** of IC documents * **Observation** of controls application * **Re-performance** (verification)

Timeliness -> usually Test at interim & *update* to extent necessary at year-end; **BEWARE** of *extrapolating beyond period*

* *must consider* if additional Tests necessary *after year-end* for assurance that controls functioned over *entire* period

Evidence on Operating Effectiveness from Prior-Period -> NOT allowed by PCAOB to be used in current audit

* Non-public: OK to use only for specific controls that auditor determined have *not changed* since prior audit

* **MUST** test Op. Effectiveness for any *Control changes* * **even if no changes**, **MUST** test *at least* every 3 years

IT Controls testing -> generally multiple testing; BUT if Control is *performed by computer*, OK to *only test once/few times*

* computers are *inherently* consistent; BUT depends on confidence that control *always* operated & data access

Evaluating Results of Tests of Controls & Impact on Planned Substantive Procedures

1) if Controls operate *as expected*, then generally *no changes* to planned substantive

2) if *not as expected*, then Increase scope of substantive