

Checkpoint Contents

Accounting, Audit & Corporate Finance Library

Editorial Materials

Audit and Attest

Audits of Nonpublic Companies

Chapter 1 Introduction and Overview

100 Introduction

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## 100 Introduction

100.1 The objective of an audit is to express an opinion about whether the financial statements are fairly presented in conformity with the applicable financial reporting framework that is used by the entity.<sup>1</sup> The auditor has a responsibility to plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud. The auditor plans, conducts, and reports the results of the audit in accordance with generally accepted auditing standards (GAAS).

100.2 PPC's *Guide to Audits of Nonpublic Companies* (the *Guide*) provides a streamlined, technically sound audit approach for nonpublic commercial entities. It provides auditors a flexible, adaptable audit process that is thorough, yet practical; effective, yet efficient. The audit approach in this *Guide* enhances audit quality by ensuring compliance with GAAS. Further, auditors can consistently apply this effective audit process across all nonpublic commercial audit engagements, which helps to ensure compliance with the firm's system of quality control and minimize firm risk and legal liability exposure.

100.3 The *Guide* includes:

- Audit programs that can be easily tailored to address the risks associated with your individual audit engagements.<sup>2</sup>
- A complete, up-to-date set of easy-to-use practice aids.
- Practical, "how-to" text guidance and answers to all your auditing questions.

100.4 This *Guide* shows the auditor of a nonpublic company how to plan and conduct effective audits that meet professional standards without unnecessary and unproductive procedures.<sup>3</sup>

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- 1** The applicable financial reporting framework is the set of accounting principles used by the entity to prepare its financial statements. This *Guide* assumes that entities are following U.S. generally accepted accounting principles.
- 2** Chapter 4 provides a detailed discussion of the audit programs included in this *Guide*.
- 3** This *Guide* does not address engagements where the auditor is performing an examination of the design and operating effectiveness of internal control over financial reporting that is integrated with the audit of the financial statements as addressed by AT 501, *An Examination of an Entity's Internal Control Over Financial Reporting That is Integrated With an Audit of its Financial Statements*. The AICPA's Auditing Standard Board currently has a project that would move and modify the guidance in AT 501 from the attestation standards into the auditing standards.

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## Checkpoint Contents

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Chapter 1 Introduction and Overview

101 Authoritative Literature

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# 101 Authoritative Literature

## Generally Accepted Accounting Principles

101.1 FASB ASC 105, *Generally Accepted Accounting Principles*, establishes the Financial Accounting Standards Board (FASB) Accounting Standards Codification as the source of generally accepted accounting principles for nongovernmental entities. This *Guide* is updated for changes in accounting standards. To assist auditors in monitoring the status of professional literature, Appendix 1A provides a list of significant accounting pronouncements applicable to nonpublic entities that were issued between July 1, 2014, and February 2, 2015, took effect in late 2014, or will become effective during 2015 or thereafter. *PPC's Guide to Preparing Financial Statements* provides detailed guidance on generally accepted accounting principles.

## Generally Accepted Auditing Standards

101.2 Auditors of nonpublic entities should conduct their engagements in accordance with GAAS developed by the American Institute of Certified Public Accountants (AICPA). The AICPA revised *Code of Professional Conduct* requires members to comply with SASs.<sup>4</sup> This *Guide* is updated for changes in professional literature and includes guidance about how those changes might affect audits of nonpublic companies. However, even when using the practice aids in this *Guide*, auditors are responsible for awareness and timely implementation of new pronouncements. The authors recommend that firms have a system in place to ensure staff members are informed about current authoritative literature.

101.3 **Defining Professional Responsibility** The auditor's degree of responsibility in complying with professional requirements is identified through two categories as follows (AU-C 200.25):

- *Unconditional Requirements.* Unconditional requirements are those that an auditor must follow in all cases if the circumstances apply to the requirement. Auditing standards use the word *must* to indicate an unconditional requirement.

- **Presumptively Mandatory Requirements.** An auditor must comply with a presumptively mandatory requirement in all cases in which such a requirement is relevant except in rare circumstances when the auditor determines it necessary to depart from a relevant requirement. In that case, the auditor should perform alternative procedures to achieve the intent of the requirement (see AU-C 200.26). Auditing standards use the word *should* to indicate a presumptively mandatory requirement.

As discussed in paragraph 801.2, the auditor *must* document the justification for any necessary departure from a presumptively mandatory requirement of GAAS, along with how alternative procedures performed sufficiently achieve the intent of the requirement.

**101.4 Use of the Terms *Must* and *Should*** Throughout this *Guide*, the authors use the terms *must* and *should* in accordance with AU-C 200.25. The authors also use the term *is required* interchangeably with *should*.

**101.5 Form and Structure of the Auditing Standards** Each auditing standard is divided into the following topics:

- ***Introduction.*** Includes matters such as the purpose and scope of the guidance, subject matter, effective date, and other introductory material.
- ***Objectives.*** Establishes objectives that allow the auditor to understand what he or she should achieve under the standards. The auditor uses the objectives to determine whether additional procedures are necessary for their achievement and to evaluate whether sufficient appropriate audit evidence has been obtained.
- ***Definitions.*** Provides key definitions that are relevant to the standard.
- ***Requirements.*** States the requirements that the auditor is to follow to achieve the objectives unless the standard is not relevant or the requirement is conditional and the condition does not exist.
- ***Application and Other Explanatory Material.*** Provides further guidance to the auditor in applying or understanding the requirements. While this material does not in itself impose a requirement, auditors should understand this guidance. How it is applied will depend on professional judgment in the circumstances considering the objectives of the standard. The requirements section

references the related application and explanatory material. Also, when appropriate, considerations relating to smaller and less complex entities are included in this section.

101.6 A standard may also contain exhibits or appendices. Appendices to a standard are part of the application and other explanatory material. The purpose and intended use of an appendix is explained in the standard or in the title and introduction of the appendix. Exhibits to standards are interpretive publications. Interpretive publications are not auditing standards and do not contain requirements. Rather, they are recommendations on applying the standards in particular circumstances that are issued under the authority of the Auditing Standards Board. Auditors are required to consider applicable interpretive publications when planning and performing the audit.

**101.7 AU-C Section Organization** Within the AICPA Professional Standards, the auditing standards use “AU-C” section numbers. The organization of AU-C sections is as follows:

- Preface.
- Glossary.
- AU-C Section 200-299: General Principles and Responsibilities.
- AU-C Section 300-499: Risk Assessment and Response to Assessed Risks.
- AU-C Section 500-599: Audit Evidence.
- AU-C Section 600-699: Using the Work of Others.
- AU-C Section 700-799: Audit Conclusions and Reporting.
- AU-C Section 800-899: Special Considerations.
- AU-C Section 900-999: Special Considerations in the United States.

- Exhibits and Appendices.

**101.8 Preface** AU-C Preface—*Principles Underlying an Audit Conducted in Accordance With Generally Accepted Auditing Standards*, contains the principles underlying an audit conducted in accordance with generally accepted auditing standards (the principles). These principles are not requirements and are not authoritative. They provide a framework that is helpful in understanding and explaining an audit and are organized to provide a structure for the codification of SASs. The structure addresses the purpose of an audit, responsibilities of the auditor, performance of the audit, and reporting.

**101.9 Overall Objectives and Requirements** AU-C 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*, contains the auditor's overall responsibilities in accordance with GAAS. The overall objectives of the auditor in conducting an audit of financial statements are as follows:

- Obtain reasonable assurance about whether the financial statements are free from material misstatement.
- In accordance with the auditor's findings, (a) report on the financial statements, and (b) make the communications required by GAAS.

**101.10** The auditor must be independent of the entity when performing an engagement in accordance with GAAS unless (a) GAAS provides otherwise, or (b) law or regulation requires accepting the engagement and reporting on the financial statements. In addition, the auditor should follow the requirements in Exhibit 1-1 to achieve the objectives in paragraph 101.9. These overall requirements are discussed throughout the *Guide* as appropriate.

### Exhibit 1-1

#### **Requirements for Overall Objectives and the Conduct of an Audit in Accordance with Generally Accepted Auditing Standards**

Requirements	AU-C Reference
Be independent of the entity when performing an engagement in accordance with GAAS unless (1) GAAS provides otherwise, or (2) law or regulation requires	AU-C 200.15

accepting the engagement and reporting on the financial statements (“must” statement). If not independent and neither (1) nor (2) apply, do not issue a report under GAAS.	
Follow relevant ethical requirements relating to financial statement audit engagements.	AU-C 200.16
Maintain professional skepticism throughout the audit, recognizing the possibility that a material misstatement of the financial statements may exist.	AU-C 200.17
Exercise professional judgment in planning and performing the audit.	AU-C 200.18
To obtain reasonable assurance, obtain sufficient appropriate audit evidence to reduce audit risk to an acceptably low level.	AU-C 200.19
Comply with all AU-C sections when the AU-C section is effective and the circumstances addressed by the AU-C section exist.	AU-C 200.20
Understand the entire text of an AU-C section, including its application and other explanatory material, to understand its objectives and to apply its requirements properly.	AU-C 200.21
Do not represent compliance with GAAS in the auditor's report unless the requirements of AU-C 220 and all other relevant AU-C sections have been followed.	AU-C 200.22
In planning and performing the audit, use the objectives stated in the individual AU-C sections to achieve the overall objectives of the auditor and to: <ul style="list-style-type: none"> <li>• Determine whether any audit procedures in addition to those required by individual AU-C sections are necessary.</li> <li>• Evaluate whether sufficient appropriate audit evidence has been</li> </ul>	AU-C 200.23

obtained.		
Subject to AU-C 220.26, comply with each requirement of an AU-C section unless (1) the entire AU-C section is not relevant or (2) the requirement is not relevant because it is conditional and the condition does not exist.	AU-C 200.24	
<p>Identify the auditor's degree of responsibility in complying with professional requirements according to the following categories:<sup>a</sup></p> <ul style="list-style-type: none"> <li>• <i>Unconditional requirements.</i> Requirements an auditor must follow in all cases if the circumstances apply to the requirement. Auditing standards use the word "must" to indicate an unconditional requirement.</li> <li>• <i>Presumptively mandatory requirements.</i> Requirements an auditor must follow in all cases if the circumstances apply to the requirement, except in rare circumstances discussed in AU-C 220.26. Auditing standards use the word "should" to indicate a presumptively mandatory requirement.</li> </ul>	AU-C 200.25	
In rare situations, when the auditor determines it is necessary to depart from a relevant presumptively mandatory requirement, perform alternative audit procedures to achieve the intent of that requirement. It is expected that departure from a relevant presumptively mandatory requirement will only occur when the requirement is for a specific procedure to be performed and, in the specific circumstances of the audit, that procedure would be ineffective in achieving the intent of the requirement.	AU-C 200.26	
In planning and performing the audit, consider applicable interpretive publications.	AU-C 200.27	
In applying the auditing guidance included in other auditing publications, use	AU-C 200.28	

professional judgment and assess the relevance and appropriateness of such guidance.		
<p>Evaluate whether not achieving an objective in a relevant AU-C section prevents achievement of the overall objectives of the engagement. If the overall objective of the engagement is not achieved, modify the opinion or withdraw from the engagement (when withdrawal is possible under applicable law or regulation). Document the failure to achieve an objective as a significant finding or issue in accordance with AU-C 230.</p>	AU-C 200.29	

#### Notes:

- <sup>a</sup> See discussion of the terms *must* and *should* at paragraph 101.4.
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**101.11 Interpretive Publications** Interpretive publications are not auditing standards, but rather recommendations on applying the SASs. Interpretive publications include Auditing Interpretations, exhibits to the SASs, AICPA Audit and Accounting Guides, and AICPA Auditing Statements of Position. Auditors should consider applicable interpretive publications. If the auditor does not apply an interpretive publication, the auditor should be prepared to explain how he or she complied with the underlying SAS provisions. The unconditional requirements and presumptively mandatory requirements are not intended to apply to interpretive guidance issued by the AICPA.

**101.12 Other Auditing Publications** Other auditing publications have no authoritative status but may help auditors understand and apply the SASs. Other auditing publications include AICPA publications other than SASs and interpretive publications, articles in professional journals, continuing professional education programs, textbooks, guide books, audit programs and checklists, and auditing literature published by state CPA societies and other organizations (for example, PPC guides).<sup>5</sup> If auditors apply the guidance in other auditing publications, they should satisfy themselves that the guidance is both appropriate and relevant. Appropriateness refers to whether the guidance is technically sound. Relevance refers to whether the guidance is applicable to the circumstances of a particular audit engagement. Indicators of appropriateness include the extent to which the publication is recognized as being helpful and the professional qualifications of its author or issuer. There is a presumption that other auditing publications reviewed by the AICPA Audit and Attest Standards staff (such as auditing practice releases and AICPA risk alerts) are appropriate.

## **Quality Control**

**101.13 Statement on Quality Control Standards** Statement on Quality Control Standard No. 8, *A Firm's System of Quality Control*, establishes standards and provides guidance for a CPA firm's responsibilities for its system of quality control for its accounting and auditing practice. SQCS No. 8 comprehensively addresses the quality control processes over a firm's accounting and auditing practice. The standard places an unconditional obligation on the firm to establish a QC system designed to provide reasonable assurance that the firm complies with professional standards and legal and regulatory requirements, and that it issues reports that are appropriate in the circumstances. *PPC's Guide to Quality Control* provides guidance and practice aids to assist firms in developing, implementing, and maintaining a system of quality control.

**101.14 Quality Control Auditing Standard** AU-C 220, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, provides requirements and application and other explanatory material to the auditor and engagement partner as they implement each element of quality control during the performance of an audit of financial statements. Thus, for every quality control element discussed in SQCS No. 8, AU-C 220 includes information that conveys how the firm ensures that the requirements of SQCS No. 8 are met in an audit engagement. The responsibility to ensure compliance with AU-C 220 is primarily placed on the audit engagement partner. However, certain requirements are also imposed on the engagement team and, if applicable, engagement quality control reviewer. In meeting the requirements of the quality control auditing standard, the engagement partner is permitted to delegate his or her responsibilities and to rely on the firm's quality control system.

101.15 The objective is for the auditor to implement quality control procedures at the engagement level that provide reasonable assurance that—

- The audit has been performed in accordance with professional standards and meets applicable legal and regulatory requirements.
- In the circumstances, the auditor's report is appropriate.

101.16 The requirements that should be followed to achieve that objective are summarized in Exhibit 1-2.

### **Exhibit 1-2**

#### **Requirements for Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards**

Requirements	AU-C Reference	Reference—Practice Aid
<b>Leadership Responsibilities for Quality on Audits</b>		
The engagement partner should take responsibility for the overall quality on each assigned audit engagement. The performance of certain procedures may be delegated to other members of the engagement team and the engagement partner may rely on the firm's system of quality control.	AU-C 220.10	ASB-CX-14
<b>Relevant Ethical Requirements</b>		
The engagement partner and other members of the engagement team should remain alert for evidence of noncompliance with relevant ethical requirements by members of the engagement team.	AU-C 220.11	ASB-AP-1
If there is indication that members of the engagement team have not complied with relevant ethical requirements, the engagement partner, in consultation with others in the firm as appropriate, should determine that appropriate action has been taken.	AU-C 220.12	ASB-CX-14
<p>To form a conclusion on compliance with independence requirements that apply to the audit engagement, the engagement partner should—</p> <ul style="list-style-type: none"> <li>• Obtain relevant information from the firm and, when applicable, network firms to identify and evaluate circumstances and relationships that create threats to independence.</li> <li>• Evaluate information that a breach of the firm's independence policies and procedures has occurred and determine whether the situation creates a threat to independence for the audit.</li> <li>• Take appropriate action to eliminate any identified threats or to reduce them to an acceptable level by applying safeguards.</li> </ul> <p>Report any inability to resolve the matter promptly to the firm so that it may take appropriate action.</p>	AU-C 220.13	ASB-CX-1.1 ASB-CX-1.2
<b>Acceptance and Continuance of Client Relationships and Audit Engagements</b>		
The engagement partner should determine that appropriate procedures regarding the acceptance and continuance of client relationships and audit engagements have been followed and all conclusions reached are appropriate.	AU-C 220.14	ASB-CX-1.1
If the engagement partner obtains information that would have caused the firm to decline the audit engagement had that information been available earlier, the engagement partner should communicate that information promptly to other members of the firm and take the necessary action.	AU-C 220.15	ASB-AP-1

**Assignment of Engagement Teams**

The engagement partner should be satisfied that the audit engagement team (including any external specialists) has the appropriate competence and capabilities to (a) perform the audit engagement as required by professional standards and applicable legal and regulatory requirements, and (b) enable the issuance of an auditor's report that is appropriate in the circumstances.	AU-C 220.16	ASB-AP-1 ASB-CX-1.1
<b>Engagement Performance</b>		
The engagement partner should take responsibility for the direction, supervision, and performance of the audit engagement. The engagement partner is charged with ensuring that (1) professional standards and applicable legal and regulatory requirements and the firm's policies and procedures are followed and (2) the auditor's report is appropriate in the circumstances.	AU-C 220.17	ASB-CX-14
The engagement partner should ensure that reviews are being performed in accordance with the firm's review policies and procedures.	AU-C 220.18	ASB-CX-14
Based on the review of audit documentation and discussion with the engagement team, on or before the date of the auditor's report, the engagement partner should be satisfied that sufficient appropriate audit evidence has been gathered to support the conclusions reached and the auditor's report to be issued.	AU-C 220.19	ASB-CX-14
The engagement partner should take responsibility for the engagement team undertaking appropriate consultation on difficult or contentious matters.	AU-C 220.20	ASB-CX-14
The engagement partner should be satisfied that— <ul style="list-style-type: none"> <li>• Members of the engagement team have followed consultation policies during the course of the engagement.</li> <li>• The nature and scope of the consultation is agreed upon with the party consulted and the conclusions resulting from such consultations are understood by the party consulted.</li> <li>• The conclusions resulting from such consultations have been implemented.</li> </ul>	AU-C 220.20	ASB-CX-14
For those audit engagements, if any, for which the firm has determined that an engagement quality control review (EQCR) is required, the engagement partner should— <ul style="list-style-type: none"> <li>• Ascertain that an engagement quality control reviewer has been appointed.</li> <li>• Discuss significant findings or issues that arose during the audit engagement with the engagement quality control reviewer.</li> <li>• Ensure that the auditor's report is not released before the</li> </ul>	AU-C 220.21	ASB-CX-14

EQCR is completed.		
The engagement quality control reviewer should perform an objective evaluation of the significant judgments made and the conclusions reached in formulating the auditor's report. This evaluation should involve— <ul style="list-style-type: none"> <li>• Discussing significant findings or issues with the engagement partner.</li> <li>• Reading the financial statements and the proposed report.</li> <li>• Reviewing selected audit documentation relating to the significant judgments the engagement team made and the related conclusions it reached.</li> <li>• Evaluating the conclusions reached in formulating the report and considering whether the proposed report is appropriate.</li> </ul>	AU-C 220.22	ASB-CX-14
When differences of opinion occur within the engagement team, with those consulted, or between the engagement partner and the engagement quality control reviewer, the engagement team should follow the firm's policies and procedures for resolving differences of opinion.	AU-C 220.23	ASB-CX-14
<b>Monitoring</b>		
The engagement partner should consider the results of the firm's monitoring process and whether deficiencies noted in that information may affect the audit engagement.	AU-C 220.24	ASB-CX-14
<b>Documentation</b>		
The auditor should document: <ul style="list-style-type: none"> <li>• Issues identified with respect to compliance with relevant ethical requirements and how they were resolved.</li> <li>• Conclusions on compliance with independence requirements and any relevant discussions with the firm that support these conclusions.</li> <li>• Conclusions reached regarding the acceptance and continuance of client relationships and audit engagements.</li> <li>• The nature and scope of, and conclusions resulting from, consultations undertaken during the engagement.</li> </ul>	AU-C 220.25 AU-C 220.25 AU-C 220.25 AU-C 220.25	ASB-CX-1.1 ASB-CX-1.1 ASB-CX-1.2 ASB-CX-1.1  ASB-CX-14
The engagement quality control reviewer should document: <ul style="list-style-type: none"> <li>• That the procedures required by the firm's policies on engagement quality control review have been performed.</li> <li>• The date that the engagement quality control review was completed.</li> <li>• That the reviewer is not aware of any unresolved issues that</li> </ul>	AU-C 200.26	ASB-CX-14

would cause him or her to believe that the significant judgments made and the conclusions reached were not appropriate.

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**101.17 AICPA revised *Code of Professional Conduct*** The AICPA *Code of Professional Conduct* provides guidance and rules that auditors need to comply with in connection with an audit engagement. As noted in AU-C 220.A4, it sets forth the fundamental principles of professional ethics, including objectivity and independence. As noted in paragraph 101.10, the auditor is required to be independent in the audit of the financial statements. AU-C 200.16 also requires auditors to follow ethical requirements that are relevant to the engagement.

101.18 In May 2014, the AICPA issued a revised *Code of Professional Conduct* (revised Code). The revised Code was effective on December 15, 2014, with the exception of the two broad conceptual frameworks, one for members in public practice and one for members in business, that will be given a one year delayed effective date. The revised Code is divided into three parts that separately apply to members in public practice, members in business, and other members (such as retired and unemployed members), as well as a preface that applies to all members. The revised Code also establishes a new numbering system with the reference preface of "ET." In addition, the revised Code provides conceptual frameworks that set forth requirements in those situations where the member has identified a threat to compliance with the rules in the revised Code and the relationship or circumstance creating the threat is not covered within the revised Code. As noted previously, the conceptual framework guidance is not effective until December 15, 2015, but early implementation is allowed.

101.19 When applicable, this *Guide* provides references to the numbering system within the revised Code. Section 202 provides additional discussion of certain independence considerations in connection with client acceptance and continuance.

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**4** In May 2014, the AICPA issued a revised *Code of Professional Conduct* (revised Code). The revised Code was effective on December 15, 2014, with the exception of the two broad conceptual frameworks, one for members in public practice and one for members in business, that will be given a one year delayed effective date. The discussion beginning with paragraph 101.17 provides additional information on the revised Code.

**5** The AICPA is changing the reference of its Technical Questions and Answers section in the *Technical Practice Aids* from "TIS" to "Q&A". The numerical reference will remain unchanged. This *Guide* occasionally makes reference to an AICPA Technical Question and Answer and maintains the TIS designation. The next edition of this *Guide* will provide the modified designations.

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Checkpoint Contents

Accounting, Audit & Corporate Finance Library

Editorial Materials

Audit and Attest

Audits of Nonpublic Companies

Chapter 1 Introduction and Overview

102 The PPC Audit Process

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## 102 The PPC Audit Process

102.1 Generally accepted auditing standards require auditors to use information gathered about the entity and its environment (including internal control) to identify and assess the risks of material misstatement at both the overall financial statement and relevant assertion levels, and to determine the nature, timing, and extent of further audit procedures needed to respond to those risks. Further audit procedures are required to be performed to obtain audit evidence to support the auditor's opinion.

102.2 The authors have developed a practical approach to that audit process to address the requirements of authoritative literature and have designed practice aids to assist auditors in meeting those requirements. PPC's audit approach is designed to be flexible and adaptable, allowing auditors to better leverage their knowledge of the client to tailor their audit procedures. The audit approach has been divided into the following broad steps:

1 Perform procedures regarding acceptance/continuance of the client relationship, evaluate compliance with ethical requirements (including independence), and establish an understanding with the client in an engagement letter.

2 Develop a preliminary audit strategy, establish planning materiality, and perform risk assessment procedures to gather information about the entity and its environment that may be relevant in identifying risks of material misstatement of the financial statements.

3 Gather the information to understand and evaluate the design and implementation of the entity's internal control system.

4 Synthesize the information gathered, identify risks (both overall and specific) that could result

in material misstatement of the financial statements, and finalize the overall audit strategy.

5 Assess the risks of material misstatement of the entity's financial statements.

6 Develop and perform appropriate responses (further audit procedures) to the assessed risks of material misstatement of the financial statements considering the overall audit strategy and planning materiality.

7 Evaluate audit findings and evidence.

8 Prepare required reports and communications.

102.3 Although the requirements and guidance may suggest a sequential process, the audit is a continuous process of gathering, updating, and analyzing information about the fairness of presentation of amounts and disclosures in the client's financial statements. Therefore, the audit process is an iterative, nonlinear process, whereby the required procedures may be performed concurrently with other procedures. In addition, risks should be evaluated continuously throughout the audit.

### **Practice Aids**

102.4 PPC's *Guide to Audits of Nonpublic Companies* contains practice aids that guide the auditor through the entire audit process. The practice aids included in this *Guide* are discussed in the related text guidance. Section 1813 of this *Guide* contains a discussion on drafting the financial statements and the auditor's report and provides a standard report on comparative GAAP basis financial statements of a corporation. Detailed guidance on reporting is covered in PPC's *Guide to Auditor's Reports*.

102.5 PPC practice aids at the ASB-CX section of this *Guide* assist auditors in complying with professional standards and achieving an efficient workflow. At ASB-CX-0.1, the authors have indicated which practice aids should be completed on each engagement to fulfill specific professional standards. Additionally, the authors have indicated which practice aids generally, by themselves, do not fulfill a specific GAAS requirement and which practice aids assist auditors in situations that do not occur on every audit.

102.6 The auditor may choose to document audit procedures in a memo or in another form rather than using a PPC practice aid. To ensure that the alternative documentation meets the requirements

of GAAS, the authors recommend that auditors read the PPC practice aid for an indication of the matters to be considered and documented. As a general rule of thumb, the alternative documentation should address the subtitles in the PPC practice aids, thereby indicating how all the major areas for consideration in the practice aid are addressed. Case Study 2 in *PPC's Guide to Audit Risk Assessment* (Appendix B) illustrates the PPC audit process using a combination of completed PPC practice aids and memos that replace certain practice aids.

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## Checkpoint Contents

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Chapter 1 Introduction and Overview

103 Organization of This Guide

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## 103 Organization of This Guide

103.1 As previously noted, this *Guide* provides a step-by-step approach to providing audit services for nonpublic companies. The following paragraphs discuss the organization of the *Guide* in more detail.

### Chapter 2—Pre-engagement Activities

103.2 Chapter 2 explains the activities that take place (a) before an engagement is accepted and (b) in the early planning stages of an engagement.

### Chapter 3—Risk Assessment Procedures and Planning

103.3 Chapter 3's focus is on *general* planning decisions. General or preliminary planning can be distinguished from detailed planning of audit procedures—the subject of Chapter 4. Preliminary planning includes deciding on an overall strategy for the audit, obtaining an understanding of the entity and its environment, including its internal control, and making an initial assessment of audit risk and materiality.

### Chapter 4—Assessing Risks and Developing the Detailed Audit Plan

103.4 Chapter 4 focuses on (a) assessing the risks identified by the auditor throughout the process of performing the risk assessment procedures and (b) selecting responses that are appropriate to address those risks. The result of the auditor's risk assessment is the preparation of a detailed audit plan describing the nature, timing, and extent of further audit procedures.

### Chapter 5—Substantive Procedures

103.5 Chapter 5 discusses substantive procedures, which consist of tests of details and substantive analytical procedures. Included in the chapter are discussions of substantive procedures that are required in every audit engagement, and confirmation procedures.

## **Chapter 6—Testing Internal Control**

103.6 This chapter discusses tests of controls, including circumstances when tests of controls should be performed and circumstances when testing would be unnecessary or inefficient. Chapter 6 discusses the nature of tests of controls, including inquiry and observation, inspection of documents, walkthroughs, review of reconciliations and similar bookkeeping routines, and reperformance of control activities.

## **Chapter 7—Sampling in an Audit Engagement**

103.7 Chapter 7 explains how to decide the *extent* of audit tests. Decisions about extent include decisions about—

- Number of locations or components to be tested.
- Cutoff amounts for individually significant dollar items.
- Sample sizes.

## **Chapter 8—Audit Documentation**

103.8 Chapter 8 focuses on the documentation necessary to comply with professional standards and on techniques and approaches to efficient workpaper organization and preparation.

## **Chapter 9—Special Audit Considerations**

103.9 This chapter provides guidance on various audit considerations that are often unique to specific engagements. The topics discussed in the chapter include the following matters:

- Audits of group financial statements.

- Use of service organizations.

- Using specialists.

- Using the work of internal auditors.

- Auditing supplementary information.
- Using computerized data extraction techniques.
- Initial audit engagements and reaudits.
- Special client considerations.
- Reviews of interim financial information.

## **Chapters 10-17—Specific Audit Areas**

103.10 Chapters 10-17 of this *Guide* discuss audit considerations for individual audit areas. Those chapters include examples of specific responses for various types of risks that might be encountered.

## **Chapter 18—Concluding the Audit**

103.11 Chapter 18 discusses the general procedures that are necessary during the concluding phase of the audit. The general procedures discussed in this chapter are as follows:

- Procedures to search for commitments and contingencies, including obtaining lawyers' letters and other procedures relating to litigation, claims, or assessments.
- Obtaining written representations from management in a management representation letter.
- Procedures to search for subsequent events.
- Procedures to identify and evaluate the disclosure of related party relationships and transactions.

- Evaluation of whether there is a substantial doubt about the entity's ability to continue as a going concern.
- Procedures to identify and evaluate the measurement and disclosure of risks and uncertainties, estimates, and fair value.
- Procedures to summarize and evaluate the overall results of audit tests, including the evaluation of uncorrected misstatements.
- Concluding on the form of opinion on the financial statements, and communicating that opinion and significant conclusions and other matters in written and oral reports.

## **Practice Aids**

103.12 These sections of the *Guide* include all of the practice aids the auditor needs to efficiently conduct an audit in accordance with authoritative literature, including:

- Firm policies (ASB-FP).
- Checklists and practice aids (ASB-CX).
- Confirmations and correspondence letters (ASB-CL).
- Audit programs (ASB-AP, ASB-IA, ASB-AP-S).
- Interim review practice aids (ASB-IR).

