

Checkpoint Contents

Accounting, Audit & Corporate Finance Library

Editorial Materials

Audit and Attest

GAAS

Chapter 1 General Auditing Guidance

Responsibilities of Auditors and Management

Responsibilities of Auditors and Management

1.100 While auditors and management are both integrally involved in the financial reporting process, their responsibilities are very different. It is important to understand the differences and consider how they relate to the purpose of an audit and the premise upon which an audit is conducted.

Purpose of an Audit and Premise upon Which an Audit Is Conducted

1.101 Purpose

The purpose of the audit is to provide financial statement users with an opinion on whether the financial statements are presented fairly, in all material respects, in accordance with an applicable financial reporting framework. An audit conducted in accordance with GAAS and relevant ethical requirements enables the auditor to express an opinion on the financial statements.

1.102 Premise

A GAAS audit is conducted on the premise that management and those charged with governance have acknowledged certain responsibilities that are fundamental to the conduct of the audit. The audit does not relieve them of their responsibilities.

Practical Consideration. GAAS do not impose responsibilities on management or those charged with governance and do not supersede laws or regulations that establish their responsibilities.

Management's Responsibilities

1.103 Management is involved in the day-to-day operation of the organization. Management and those charged with governance (when appropriate) are responsible for designing, implementing, and maintaining internal controls relevant to preparing and presenting financial statements that are free from material misstatement due to fraud or error.

1.104 Management and those charged with governance are ultimately responsible for preparing and presenting the financial statements in accordance with the applicable financial reporting framework.

Even if the auditor makes suggestions about the form and content of the financial statements or helps to draft them (partially or entirely) based on information provided by management during the audit, management and those charged with governance are still responsible for them. The auditor's responsibility for the financial statements is limited to expressing an opinion on them.

1.105 Management and those charged with governance also have responsibilities in connection with the audit. They are responsible for providing the auditor with access to all relevant records, documents and other information that they are aware of and that the auditor requests. Those responsibilities also include allowing the auditor unrestricted access to persons within the entity in order to obtain audit evidence.

The Auditor's Responsibilities

1.106 The auditor is responsible for the conduct of the audit, including (a) having appropriate competence and capabilities to perform the audit, (b) complying with relevant ethical requirements, and (c) maintaining professional skepticism and exercising professional judgment when planning and conducting the audit.

1.107 In order to express an opinion, the auditor has to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement due to fraud or error. Reasonable assurance is obtained when the auditor has obtained sufficient appropriate audit evidence to reduce audit risk to an acceptably low level. (*Audit risk* is the risk that the auditor expresses an inappropriate opinion on financial statements that are materially misstated.) This involves—

- Planning the work and properly supervising any assistants.

- Determining and applying appropriate materiality throughout the audit.

- Identifying and assessing the risks of material misstatement due to fraud or error, based on an understanding of the entity and its environment, including internal control.

- Obtaining sufficient appropriate audit evidence about whether material misstatements exist by designing and implementing appropriate responses to assessed risks.

1.108 Reasonable assurance is a high level of assurance, but less than absolute assurance. The auditor is unable to obtain absolute assurance that the financial statements as a whole are free from material misstatement because of inherent limitations, which principally are due to the—

- Nature of financial reporting.
- Nature of audit procedures.
- Need for the audit to be conducted within a reasonable period of time and to achieve a balance between cost and benefit.

1.109 The auditor evaluates the audit evidence obtained and, based on that evaluation, either expresses a written opinion as to whether the financial statements are presented fairly, in all material respects, in accordance with the applicable financial reporting framework or states in the auditor's report that an opinion cannot be expressed.

Authority of Auditing Guidance

1.110 Although many AICPA documents discuss auditing rules and practices, they do not all have the same—or in some cases, any—authority. AU-C 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*, discusses the authority of auditing publications.

1.111 Auditing Standards

The *Compliance With Standards Rule* (ET 1.310.001) of the AICPA *Code of Professional Conduct* (discussed in Chapter 34) requires members who perform auditing services to comply with Statements on Auditing Standards issued by the Auditing Standards Board. Accordingly, the auditing standards are enforceable on members under the *Code of Professional Conduct* (AICPA Code). Because many state boards of accountancy have adopted the AICPA Code for their own regulatory purposes, the auditing standards are also enforceable under certain state laws. The auditing standards are codified in AU-C sections. They are published in the AICPA's *Journal of Accountancy* when issued and in AICPA *Professional Standards*, Volume 1 (also issued annually as the *Codification of Statements on Auditing Standards*). They are effective upon their stated effective dates; if there is no date, the standard is effective upon issuance. Unless early adoption is prohibited, the auditor may adopt an AU-C section before its effective date. (AU-C 200.A57 and 200.A59)

1.112 The auditor should comply with all AU-C sections relevant to the audit and should have sufficient knowledge of the entire text of an AU-C section, including the application and other explanatory material, to understand its objectives and apply its requirements appropriately. (AU-C 200.20-.21)

1.113 GAAS has two levels of professional requirements: (a) those that are unconditional (expressed as “must”) and (b) those that are presumptively mandatory (expressed as “should”). The distinction between the two types of requirements and the meaning of related terms are discussed in section

2.200.

1.114 Interpretive Publications

Interpretive publications are recommendations on the application of GAAS in specific circumstances, including specialized industries. Interpretative publications include the following:

- AICPA auditing interpretations.

- AU-C exhibits.

- AICPA audit and accounting guides.

- Auditing statements of position.

Current audit and accounting guides and SOPs are listed in AU-C Appendix D, *AICPA Audit and Accounting Guides and Statements of Position*. Auditors should consider applicable interpretive publications in planning and performing the audit. (AU-C 200.27) If an auditor does not apply the guidance in an applicable interpretive publication, the auditor may have to explain how he or she complied with the provisions of the standard addressed by such guidance.

1.115 *Auditing interpretations* are issued under the authority of the Auditing Standards Board. Generally, they resolve ambiguities in the language of an AU-C section, cover specific situations not addressed in a particular AU-C section, or deal with fact patterns that did not exist when a standard was originally issued. They are published in the *Journal of Accountancy* when issued and each is codified into the *Professional Standards* following the AU-C section it interprets.

1.116 *AU-C Exhibits* generally provide examples of the AU-C section's application, additional discussion, or relevant rules of other bodies. Accordingly, they are intended to be helpful but not to establish additional standards.

1.117 *Audit and accounting guides* are issued by AICPA committees charged with studying specialized topics. These include, for example, accounting and auditing for an industry (such as financial institutions) or particular auditing matters (such as consideration of internal control). Exhibit 1-1 lists current audit and accounting guides.

Exhibit 1-1

AICPA Audit and Accounting Guides

Active

Airlines

Analytical Procedures

Assessing and Responding to Audit Risk in a Financial Statement Audit

Assets Acquired to Be Used in Research and Development Activities

Audit Sampling

Auditing Revenue in Certain Industries

Brokers and Dealers in Securities

Compilation and Review Engagements

Construction Contractors

Depository and Lending Institutions: Banks and Savings Institutions, Credit Unions, Finance Companies and Mortgage Companies

Employee Benefit Plans

Entities With Oil and Gas Producing Activities

Gaming

Government Auditing Standards and Circular A-133 Audits

Health Care Entities

Investment Companies

Life and Health Insurance Entities

Not-for-Profit Entities

Property and Liability Insurance Entities

Prospective Financial Information

Reporting on Controls at a Service Organization Relevant to Security, Availability, Processing Integrity, Confidentiality, or Privacy (SOC 2SM)

Service Organizations: Reporting on Controls at a Service Organization Relevant to User Entities' Internal Control over Financial Reporting

Special Considerations in Auditing Financial Instruments

State and Local Governments

Testing Goodwill for Impairment

Valuation of Privately-Held-Company Equity Securities Issued as Compensation

Inactive

Agricultural Producers and Agricultural Cooperatives

Common Interest Realty Associations

Federal Government Contractors

Personal Financial Statements

1.118 *Statements of Position* (SOPs) are issued to achieve one or more of several objectives—to amend or interpret a previously issued audit and accounting guide; to provide guidance for specific types of engagements; or to provide guidance on specialized areas in engagements. The SOPs are published in the AICPA's *Technical Practice Aids*. Exhibit 1-2 lists current auditing and attestation SOPs.

Exhibit 1-2

Auditing and Attestation Statements of Position

92-8—*Auditing Property/Casualty Insurance Entities' Statutory Financial Statements—Applying Certain Requirements of the NAIC Annual Statement Instructions*

99-1—*Guidance to Practitioners in Conducting and Reporting on an Agreed-Upon Procedures Engagement to Assist Management in Evaluating the Effectiveness of Its Corporate Compliance Program*

00-1—*Auditing Health Care Third-Party Revenues and Related Receivables*

01-3—*Performing Agreed-Upon Procedures Engagements That Address Internal Control Over Derivative Transactions as Required by the New York State Insurance Law*

02-1—*Performing Agreed-Upon Procedures Engagements That Address Annual Claims Prompt Payment Reports as Required by the New Jersey Administrative Code*

04-1—*Auditing the Statement of Social Insurance*

07-2—*Attestation Engagements That Address Specified Compliance Control Objectives and Related Controls at Entities That Provide Services to Investment Companies, Investment Advisers, or Other Service Providers*

12-1—*Reporting Pursuant to the Global Investment Performance Standards*

13-1—*Attest Engagements on Greenhouse Gas Emissions Information*

13-2—*Performing Agreed-Upon Procedures Engagements That Address the Completeness, Mapping, Consistency, or Structure of XBRL-Formatted Information*

1.119 Other Auditing Publications

This category includes auditing guidance that has no authority under GAAS but is generally thought to be helpful in the situations addressed. Other auditing publications may be published by the AICPA or by other third-party providers, such as Thomson Reuters. The AICPA's other auditing publications include the following:

- *AICPA Technical Practice Aids*, which reflect questions received by the AICPA staff and suggested answers. *AICPA Technical Practice Aids (TIS)*, sections 8000 and 9000, deal with audit fieldwork and auditors' reports, respectively.
- *Audit Risk Alerts*, which are published annually (typically in the fall), are intended to provide an

overview of recent professional developments that might affect audits. In addition to an annual audit risk alert that provides a general update on economic, auditing, accounting, and other professional developments, annual risk alerts specific to various industries (such as construction, retail, nonprofit organizations, and state and local governments) are issued. Exhibit 1-3 lists the current AICPA audit risk alerts.

- Other AICPA publications, including the ones listed in Exhibit 1-4. (The exhibit is not intended to include all available documents.)

Practical Consideration. Other auditing publications may include articles in journals, such as the *Journal of Accountancy*, textbooks, CPE courses, guide books, audit programs and checklists, and other auditing publications from state CPA societies, other organizations, and individuals.

1.120 The auditor is not expected to be aware of the full body of other auditing publications. (AU-C 200.A82) If the auditor applies the guidance in another auditing publication, he or she needs to determine its relevance and appropriateness in the circumstances. The auditor may wish to consider the degree to which the publication is recognized as being helpful in understanding and applying GAAS and whether the publisher is recognized as an authority in auditing matters. The AICPA's other auditing publications that have been reviewed by the AICPA Audit and Attest Standards staff and are therefore presumed to be appropriate, are listed in AU-C Appendix F, *Other Auditing Publications*. (AU-C 200.A83)

Exhibit 1-3

Audit Risk Alerts

Compilation and Review Developments

Employee Benefit Plans Industry Developments

Financial Institutions Industry Developments, Including Depository and Lending Institutions and Brokers and Dealers in Securities

General Accounting and Auditing Developments

Government Auditing Standards and Circular A-133 Developments

Health Care Industry Developments

Independence and Ethics Developments

Insurance Industry Developments

Investment Companies Industry Developments

Not-for-Profit Entities Industry Developments

Real Estate and Construction Industry Developments

Service Organization Control Reports: Considerations for User and Service Auditors

State and Local Governmental Developments

Understanding the Clarified Auditing Standards

Understanding the Financial Reporting Framework for Small- and Medium-Sized Entities

Understanding the Responsibilities of Auditors for Audits of Group Financial Statements

Exhibit 1-4

Other Publications

2011 Yellow Book Independence—Nonaudit Services Documentation

Applying OCBOA in State and Local Governmental Financial Statements

Assessing and Responding to Audit Risk: International Auditing Standards

Audits of Futures Commission Merchants, Introducing Brokers, and Commodity Pools

Documenting and Testing Compliance and Internal Control Over Compliance in a Single Audit

Establishing and Maintaining a System of Quality Control for a CPA Firm's Accounting and Auditing Practice

Inside IFRS: Accounting and Financial Reporting Fundamentals

Internal Control for Today's Smart Business

Using a SOC 1SM Report in Audits of Employee Benefit Plans

Application of GAAS to Engagements

1.121 GAAS applies to all engagements covered by the auditing standards. This includes audits as well as such nonaudit engagements covered by standards, such as reports on the application of the requirements of a financial reporting framework (AU-C 915) and letters for underwriters. (AU-C 920)

1.122 Other professional services, such as compilation and review services, attestation services, consulting services, and valuation services, are covered by other standards. Standards for compilation and review engagements are discussed in Chapters 29-30, attestation engagements are discussed in Chapters 26-28, consulting engagements are discussed in Chapter 31, and valuation services are discussed in Chapter 32. In addition, the nonservice-related standards related to quality control and professional ethical requirements are discussed in Chapters 33 and 34, respectively.

Form and Structure of Auditing Standards

1.123 The clarified auditing standards use formatting techniques, such as bulleted lists, that make them easy to read and understand. In addition, each 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 applicable application and explanatory material. Also, when appropriate, considerations relating to smaller and less complex entities and to governmental entities are included in this section.

1.124 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.

1.125 As discussed in paragraph 1.111, the clarified auditing standards are codified in AU-C sections. The organization of the auditing standards 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.
- Appendixes.

Practical Consideration. The use of “AU-C” section numbers rather than “AU” section numbers is intended to avoid confusion with references to the pre-clarity “AU” sections. Although the ASB originally announced that the “AU-C” identifier would revert to “AU” for the clarified standards in 2014 when they became fully effective for all engagements, it later decided to retain the AU-C identifier indefinitely. The decision was made in light of potential issues that would arise in referring to standards in the context of multi-year engagements, such as peer reviews and comparative financial statements, and to provide easy identification of guidance and auditing policies written before 2014.

1.126 **Preface**

The preface contains the principles underlying an audit conducted in accordance with GAAS. 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 the auditing standards. The structure addresses the purpose of an audit, responsibilities of the auditor, performance of the audit, and reporting.

1.127 **Glossary**

The glossary defines terms used in GAAS. This *Guide* provides the glossary's terms and definitions in the material preceding the table of contents for auditing standards.

1.128 **AU-C Sections, Exhibits, and Appendixes**

The various AU-C sections, as well as the exhibits and appendixes, are discussed where relevant in Chapters 1-25 of this *Guide*.

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GAAS

Chapter 1 General Auditing Guidance

Auditing Standards for Public Companies

Auditing Standards for Public Companies

1.200 The Public Company Accounting Oversight Board (PCAOB) establishes standards for audits of public companies, called “issuers” under the *Sarbanes-Oxley Act of 2002*. Section 2 of the Sarbanes-Oxley Act defines *issuer* as:

“ . . . an issuer (as defined in section 3 of the Securities Exchange Act of 1934 . . .), the securities of which are registered under section 12 of that Act, or that is required to file reports under section 15(d) . . . , or that files or has filed a registration statement that has not yet become effective under the Securities Act of 1933 . . . , and that it has not withdrawn.”

1.201 Firms that audit issuers' financial statements are required to register with the PCAOB. Section 102 of the Sarbanes-Oxley Act says “it shall be unlawful for any person that is not a registered public accounting firm to prepare or issue, or to participate in the preparation or issuance of, any audit report with respect to any issuer.” Registration with the PCAOB subjects the firm to PCAOB standards and its inspections, investigations, and disciplinary process (which can involve suspension or revocation of registration, suspension or barring of individual accountants from association with a registered firm, monetary penalties, or other sanctions).

1.202 PCAOB standards are not considered generally accepted auditing standards because, as the PCAOB notes in its Auditing Standard No. 1, its rules are established pursuant to its authority under the Sarbanes-Oxley Act and not based on professional consensus. Accordingly, auditing standards for public companies are called standards of the PCAOB; GAAS refers to the AICPA-developed auditing standards applicable to nonpublic companies.

1.203 A comprehensive discussion of PCAOB standards is beyond the scope of this *Guide*. *PPC's Guide to PCAOB Audits* presents in-depth guidance on providing audit services to issuers under PCAOB standards and is designed to help firms comply with PCAOB standards as well as appropriate SEC measurement and disclosure requirements.

Practical Consideration. The AICPA Center for Audit Quality has issued nonauthoritative guidance on auditors' reports for auditors who are engaged to audit the financial statements of a nonissuer subsidiary, division, or segment of an SEC issuer when the principal auditor of the SEC issuer will make reference to the audit of the nonissuer and the nonissuer's audit report will be included in the SEC filing of the issuer.

In this situation, the audit is performed in accordance with the auditing and related professional standards of the PCAOB and the auditor's report on the financial statements makes reference to the standards of the PCAOB.

Because auditors of nonpublic company financial statements are bound by the *Compliance With Standards Rule* (ET 1.310.001) of the *AICPA Code of Professional Conduct*, which specifies use of standards promulgated by the AICPA Auditing Standards Board, an auditor applying PCAOB standards in the audit of a nonissuer also has to comply with GAAS.

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Quality Control

Quality Control

1.300 When performing an audit under professional standards, it is not enough merely to comply with GAAS. A firm is also required to comply with the *AICPA Statements on Quality Control Standards*.

1.301 There are two sets of interrelated but separate standards a firm should look to—GAAS, which relates to the conduct of an audit, and quality control standards, which relates to the firm's practice as a whole. Quality control requirements applicable to the conduct of an audit are discussed in Chapter 2; quality control standards applicable to the firm's practice as a whole are discussed in Chapter 33.

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