

2018

Wiley

PRACTITIONER'S GUIDE TO

GAAAS

Covering all SASs, SSAEs, SSARs,
and Interpretations

With complete
coverage of all the new
standards, including
the clarified
attestation standards

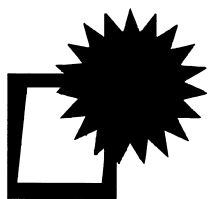
Joanne M. Flood

WILEY

WILEY

Practitioner's Guide to

GAAS
2018



Subscriber Update Service

BECOME A SUBSCRIBER!

Did you purchase this product from a bookstore?

If you did, it's important for you to become a subscriber. John Wiley & Sons, Inc. may publish, on a periodic basis, supplements and new editions to reflect the latest changes in the subject matter that you *need to know* in order stay competitive in this ever-changing industry. By contacting the Wiley office nearest you, you'll receive any current update at no additional charge. In addition, you'll receive future updates and revised or related volumes on a thirty-day examination review.

If you purchased this product directly from John Wiley & Sons, Inc., we have already recorded your subscription for this update service.

To become a subscriber, please call 1-877-762-2974 or send your name, company name (if applicable), address, and the title of the product to

mailing address: **Supplement Department
John Wiley & Sons, Inc.
One Wiley Drive
Somerset, NJ 08875**

e-mail: subscriber@wiley.com
fax: 1-732-302-2300
online: www.wiley.com

For customers outside the United States, please contact the Wiley office nearest you:

Professional & Reference Division
John Wiley & Sons Canada, Ltd.
22 Worcester Road
CANADA
416-236-4433
Phone: 1-800-567-4797
Fax: 416-236-4447
Email: canada@jwiley.com

John Wiley & Sons, Ltd.
The Atrium
Southern Gate, Chichester
West Sussex, PO 198SQ
ENGLAND
Phone: 44-1243-779777
Fax: 44-1243-775878
Email: customer@wiley.co.uk

John Wiley & Sons Australia, Ltd.
33 Park Road
P.O. Box 1226
Milton, Queensland 4064
AUSTRALIA
Phone: 61-7-3859-9755
Fax: 61-7-3859-9715
Email: brisbane@johnwiley.com.au

John Wiley & Sons (Asia) Pte. Ltd.
2 Clementi Loop # 02-01
SINGAPORE 129809
Phone: 65-64632400
Fax: 65-64634604/5/6
Customer Service: 65-64604280
Email: enquiry@wiley.com.sg

WILEY

Practitioner's Guide to
GAAS
2018

**Covering All SASs,
SSAEs, SSARSs,
and Interpretations**

Joanne M. Flood

WILEY

Cover design and image: Wiley

Copyright © 2018 by John Wiley & Sons, Inc. All rights reserved.

Published by John Wiley & Sons, Inc., Hoboken, New Jersey.
Published simultaneously in Canada.

The book contains numerous excerpts taken from the Statements on Auditing Standards, the Statements on Standards for Attestation Engagements, and the Statements on Standards for Accounting and Review Services, and interpretations of these statements. These are noted by reference to the specific standard or AICPA Codification section, except for definitions which appear under a separate heading at the beginning of each section. These standards are copyrighted by the American Institute of Certified Public Accountants, Inc. and reprinted with permission of the AICPA.

This book contains definitions taken from Statement of Financial Accounting Concepts 2, *Qualitative Characteristics of Accounting Information*; and Statement of Financial Accounting Concepts 7, *Using Cash Flow Information and Present Value in Accounting Measurements*, which are copyrighted by the Financial Accounting Standards Board, 401 Merritt 7, PO Box 5116, Norwalk, Connecticut 06856-5116, USA. Portions are reprinted with permission. Complete copies of these documents are available from the FASB.

No part of this publication may be reproduced, stored in a retrieval system, or transmitted in any form or by any means, electronic, mechanical, photocopying, recording, scanning, or otherwise, except as permitted under Section 107 or 108 of the 1976 United States Copyright Act, without either the prior written permission of the Publisher, or authorization through payment of the appropriate per-copy fee to the Copyright Clearance Center, Inc., 222 Rosewood Drive, Danvers, MA 01923, (978) 750-8400, fax (978) 646-8600, or on the Web at www.copyright.com. Requests to the Publisher for permission should be addressed to the Permissions Department, John Wiley & Sons, Inc., 111 River Street, Hoboken, NJ 07030, (201) 748-6011, fax (201) 748-6008, or online at www.wiley.com/go/permissions.

Limit of Liability/Disclaimer of Warranty: While the publisher and author have used their best efforts in preparing this book, they make no representations or warranties with respect to the accuracy or completeness of the contents of this book and specifically disclaim any implied warranties of merchantability or fitness for a particular purpose. No warranty may be created or extended by sales representatives or written sales materials. The advice and strategies contained herein may not be suitable for your situation. You should consult with a professional where appropriate. Neither the publisher nor author shall be liable for any loss of profit or any other commercial damages, including but not limited to special, incidental, consequential, or other damages.

For general information on our other products and services or for technical support, please contact our Customer Care Department within the United States at (800) 762-2974, outside the United States at (317) 572-3993, or fax (317) 572-4002.

Wiley publishes in a variety of print and electronic formats and by print-on-demand. Some material included with standard print versions of this book may not be included in e-books or in print-on-demand. If this book refers to media such as a CD or DVD that is not included in the version you purchased, you may download this material at <http://booksupport.wiley.com>. For more information about Wiley products, visit www.wiley.com.

ISBN 978-1-119-39648-2 (Paperback)
ISBN 978-1-119-39652-9 (ePDF)
ISBN 978-1-119-39655-0 (ePub)
ISBN 978-1-119-39653-6 (obk)

Printed in the United States of America

10 9 8 7 6 5 4 3 2 1

CONTENTS

	Preface—Organization and Key Changes	ix
	About the Author	xi
AU-C 200	Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Generally Accepted Auditing Standards	1
AU-C 210	Terms of Engagement	9
AU-C 220	Quality Control for an Engagement Conducted in Accordance with Generally Accepted Auditing Standards	15
AU-C 230	Audit Documentation	21
AU-C 240	Consideration of Fraud in a Financial Statement Audit	33
AU-C 250	Consideration of Laws and Regulations in an Audit of Financial Statements	61
AU-C 260	The Auditor’s Communication with Those Charged with Governance	67
AU-C 265	Communicating Internal Control Related Matters Identified in an Audit	73
AU-C 300	Planning an Audit	83
AU-C 315	Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement	89
AU-C 320	Materiality in Planning and Performing an Audit	117
AU-C 330	Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained	121
AU-C 402	Audit Considerations Relating to an Entity Using a Service Organization	151
AU-C 450	Evaluation of Misstatements Identified during the Audit	161
AU-C 500	Audit Evidence	165
AU-C 501	Audit Evidence—Specific Considerations for Selected Items	169
AU-C 505	External Confirmations	203
AU-C 510	Opening Balances—Initial Audit Engagements, Including Reaudit Engagements	219
AU-C 520	Analytical Procedures	227
AU-C 530	Audit Sampling	241

Contents

AU-C 540	Auditing Accounting Estimates, Including Fair Value Accounting Estimates and Related Disclosures	265
AU-C 550	Related Parties	277
AU-C 560	Subsequent Events and Subsequently Discovered Facts	289
AU-C 570	The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern	303
AU-C 580	Written Representations	319
AU-C 585	Consideration of Omitted Procedures after the Report Release Date	333
AU-C 600	Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)	339
AU-C 610	Using the Work of Internal Auditors	359
AU-C 620	Using the Work of an Auditor's Specialist	373
AU-C 700	Forming an Opinion and Reporting on Financial Statements	383
AU-C 705	Modifications to the Opinion in the Independent Auditor's Report	397
AU-C 706	Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report	415
AU-C 708	Consistency of Financial Statements	423
AU-C 720	Other Information in Documents Containing Audited Financial Statements	427
AU-C 725	Supplementary Information in Relation to The Financial Statements as a Whole	431
AU-C 730	Required Supplementary Information	437
AU-C 800	Special Considerations—Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks	443
AU-C 805	Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement	453
AU-C 806	Reporting on Compliance with Aspects of Contractual Agreements or Regulatory Requirements in Connection with Audited Financial Statements	463
AU-C 810	Engagements to Report on Summary Financial Statements	471
AU-C 905	Alert That Restricts the Use of the Auditor's Written Communication	481
AU-C 910	Financial Statements Prepared in Accordance with a Financial Reporting Framework Generally Accepted in Another Country	487
AU-C 915	Reports on Application of Requirements of an Applicable Financial Reporting Framework	493

Contents

vii

AU-C 920	Letters for Underwriters and Certain Other Requesting Parties	499
AU-C 925	Filings with the US Securities and Exchange Commission under the Securities Act of 1933	537
AU-C 930	Interim Financial Information	543
AU-C 935	Compliance Audits	571
AU-C 940	An Audit of Internal Control over Financial Reporting That Is Integrated With an Audit of Financial Statements	583
AU-C 945	Auditor Involvement With Exempt Offering Documents	609
AT-C	Preface	613
AT-C 105	Concepts Common to All Attestation Engagements	627
AT-C 205	Examination Engagements	633
AT-C 210	Review Engagements	655
AT-C 215	Agreed-Upon Procedures Engagements	671
AT-C 305	Prospective Financial Information	685
AT-C 310	Reporting on Pro Forma Financial Information	697
AT-C 315	Compliance Attestation	711
AT-C 320	Reporting on an Examination of Controls at a Service Organization Relevant to User Entities' Internal Control over Financial Reporting	721
AT-C Section 395	(Designated for AT Section 701) Management's Discussion and Analysis (MD&A)—A Summary	737
AR-C 60	General Principles for Engagements Performed in Accordance with Statements on Standards for Accounting and Review Services	745
AR-C 70	Preparation of Financial Statements	753
AR-C 80	Compilation Engagements	761
AR-C 90	Review of Financial Statements	785
AR-C 120	Compilation of Pro Forma Financial Information	823
Appendix A	Cross-References to SASs, SSAEs, and SSARSs	829
Appendix B	List of AICPA Audit and Accounting Guides and AICPA Statements of Position—Auditing and Attestation	831
Appendix C	Other Auditing Publications	833
Index		835

PREFACE—ORGANIZATION AND KEY CHANGES

This book reduces the official language of Statements on Auditing Standards (SASs), Statements on Standards for Attestation Engagements (SSAEs), Statements on Standards for Accounting and Review Services (SSARs), and the interpretations of those standards into easy-to-read and understandable advice. It is designed to help CPAs in the application of, and compliance with, authoritative standards.

CLARIFIED AUDITING STANDARDS

The AICPA's clarified auditing standards are now fully implemented. This Preface contains additional information on the clarity project.

This book follows the sequence of sections of the AICPA *Codification of Statements on Auditing Standards*, the *Codification of Statements on Standards for Attestation Engagements*, and the *Codification of Statements on Standards for Accounting and Review Services*. Sections are divided into the following easy-to-understand parts:

Original Pronouncement. A handy, brief identification of the original standard for the Section.

Definitions of Terms. A glossary of official definitions that gathers in one place explanations of terms that are ordinarily scattered throughout a standard.

Objectives of Section. A behind-the-scenes explanation of the reasons for the pronouncement and a capsule explanation of the most basic ideas of the section.

Requirements. Concise listing and descriptions of those things specifically mandated by the section, and helpful techniques for complying with the fundamental requirements of the section.

Interpretations. A brief summary of each Interpretation.

Since the last edition of *Wiley GAAS* was published, the ASB issued two SASs:

- SAS No. 132, on auditor involvement with exempt offering documents. Codified in AU-C 945.
- SAS No. 133, on an auditor's consideration of an entity's ability to continue as a going concern (AU-C 570). This guidance better aligns the AICPA with the FASB, the Governmental Accounting Standards Board (GASB), and International guidance.

More information on both these standards can be found in the relevant chapters.

CLARIFIED ATTESTATION STANDARDS

SSAE 18 supersedes all existing AT sections and is effective for reports dated after April 30, 2017. The guidance from SSAE 18 is codified in the AT-C sections of AICPA professional standards and appears in the AT-C chapters of this book.

Preface

ACCOUNTING AND REVIEW STANDARDS

In October 2016, the ARSC issued SSARS 23, *Omnibus Statement on Standards for Accounting and Review Services—2016*. The SSARS amends various paragraphs in the AR-C standards related to

- Supplementary information in compilation and review reports that accompanies the financial statements, and
- Known departures in compilation reports.

The changes are included in the appropriate chapters in this book.

RESOURCES

Wiley Practitioner's Guide to GAAS 2017 contains robust tools to help practitioners implement the clarified standards. Each chapter begins with the source of the code section, the clarified objectives, and definitions, followed by practice guidance. Exhibits and illustrations are integrated into the chapter and clearly identified. Clarified standard references are preceded by "AR-C."

The AICPA has dedicated a page on its site to the SSARS clarity project, with links to additional resources that may be helpful in implementing the changes: <http://www.aicpa.org/interestareas/frc/reviewcompilationpreparation/arscclarityproject.html>.

ON THE HORIZON

AUDITING STANDARDS

The Auditing Standards Board (ASB) has issued an exposure draft to consider changes in the auditor's report in light of IAASB and PCAOB projects. Comment letters for that project are due in January 2018.

ATTESTATION STANDARDS

The ASB has a project to develop standards for attestation engagements that do not require a written assertion. An ED for this project was issued in Fall 2017.

ACCOUNTING AND REVIEW STANDARDS

The ARSC issued an Omnibus ED in Fall 2017. If finalized the standard would create a new AR-C section 100 on international reporting issues, make changes regarding technical corrections in a review report, going concern related guidance, and more.

This publication is current through SAS No. 133, SSARS 23, and SSAE 18.

Joanne M. Flood
September 2017

ABOUT THE AUTHOR

Joanne M. Flood, CPA, is an author and independent consultant on accounting and auditing technical topics and e-learning. She has experience as an auditor in both an international firm and a local firm and worked as a senior manager in the AICPA's Professional Development group. She received her MBA summa cum laude in accounting from Adelphi University and her bachelor's degree in English from Molloy College. Joanne received the New York State Society of Certified Public Accountants Award of Honor for outstanding scholastic achievement at Adelphi University. Joanne also has a certificate in Designing Interactive Multimedia Instruction from Teachers College, Columbia University.

While in public accounting, Joanne worked on major clients in retail, manufacturing, and finance and on small business clients in construction, manufacturing, and professional services. At the AICPA, Joanne developed and wrote e-learning, text, and instructor-led training courses on US and international standards. She also produced training materials in a wide variety of media, including print, video, and audio, and pioneered the AICPA's e-learning product line. Joanne resides on Long Island, New York, with her daughter, Elizabeth. Joanne is the author of the following Wiley publications:

Financial Disclosure Checklist

Wiley GAAP 2018: Interpretation and Application of Generally Accepted Accounting Principles

Wiley Practitioner's Guide to GAAS 2018: Covering All SASs, SSAEs, SSARSs, and Interpretations

Wiley GAAP: Financial Statement Disclosures Manual (Wiley Regulatory Reporting), coming soon

Wiley Revenue Recognition

And the following AICPA online and live CPE programs:

Audit Staff Essentials, Level 1—New Hire

Audit Staff Essentials, Level 2—Experienced Staff

Audit Staff Essentials, Level 3—Audit Senior/In-Charge

AU-C 200 Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Generally Accepted Auditing Standards

AU-C ORIGINAL PRONOUNCEMENTS

Sources Statements on Auditing Standards (SASs) 122, 123, 128, and 130.

AU-C 200 DEFINITIONS OF TERMS

Source: AU-C 200.14

Applicable financial reporting framework. The financial reporting framework adopted by management and, when appropriate, those charged with governance in the preparation and fair presentation of the financial statements that is acceptable in view of the nature of the entity and the objective of the financial statements, or that is required by law or regulation.

Audit evidence. Information used by the auditor in arriving at the conclusions on which the auditor's opinion is based. Audit evidence includes both information contained in the accounting records underlying the financial statements and other information. *Sufficiency of audit evidence* is the measure of the quantity of audit evidence. The quantity of the audit evidence needed is affected by the auditor's assessment of the risks of material misstatement and also by the quality of such audit evidence. *Appropriateness of audit evidence* is the measure of the quality of audit evidence; that is, its relevance and its reliability in providing support for the conclusions on which the auditor's opinion is based.

Audit risk. The risk that the auditor expresses an inappropriate audit opinion when the financial statements are materially misstated. Audit risk is a function of the risk of material misstatement and detection risk.

Auditor. The term used to refer to the person or persons conducting the audit, usually the engagement partner or other members of the engagement team or, as applicable, the firm. When an AU-C section expressly intends that a requirement or responsibility be fulfilled by the engagement partner, the term *engagement partner* rather than *auditor* is used. *Engagement partner* and *firm* are to be read as referring to their governmental equivalents when relevant.

Detection risk. The risk that the procedures performed by the auditor to reduce audit risk to an acceptably low level will not detect a misstatement that exists and that could be material, either individually or when aggregated with other misstatements.

AU-C 200 Overall Objectives of the Independent Auditor . . .

Financial reporting framework. A set of criteria used to determine measurement, recognition, presentation, and disclosure of all material items appearing in the financial statements; for example, US generally accepted accounting principles, International Financial Reporting Standards (IFRSs) promulgated by the International Accounting Standards Board (IASB), or a special purpose framework.

The term *fair presentation framework* is used to refer to a financial reporting framework that requires compliance with the requirements of the framework and:

1. Acknowledges explicitly or implicitly that, to achieve fair presentation of the financial statements, it may be necessary for management to provide disclosures beyond those specifically required by the framework; or
2. Acknowledges explicitly that it may be necessary for management to depart from a requirement of the framework to achieve fair presentation of the financial statements. Such departures are expected to be necessary only in extremely rare circumstances.

A financial reporting framework that requires compliance with the requirements of the framework but does not contain the acknowledgments in 1 or 2 is not a fair presentation framework.

Financial statements. A structured representation of historical financial information, including related notes, intended to communicate an entity's economic resources and obligations at a point in time or the changes therein for a period of time in accordance with a financial reporting framework. The related notes ordinarily comprise a summary of significant accounting policies and other explanatory information. The term *financial statements* ordinarily refers to a complete set of financial statements as determined by the requirements of the applicable financial reporting framework, but can also refer to a single financial statement.

Historical financial information. Information expressed in financial terms regarding a particular entity, derived primarily from that entity's accounting system, about economic events occurring in past time periods or about economic conditions or circumstances at points in time in the past.

Interpretive publications. Auditing interpretations of generally accepted accounting standards (GAAS), exhibits to GAAS, auditing guidance included in the American Institute of Certified Public Accountants (AICPA) Audit and Accounting Guides, and the AICPA Auditing Statements of Position (SOPs).

Management. The person(s) with executive responsibility for the conduct of the entity's operations. For some entities, management includes some or all of those charged with governance; for example, executive members of a governance board or an owner-manager.

Misstatement. A difference between the amount, classification, presentation, or disclosure of a reported financial statement item and the amount, classification, presentation, or disclosure that is required for the item to be presented fairly in accordance with the applicable financial reporting framework. Misstatements can arise from fraud or error.

Other auditing publications. Publications other than interpretive publications; these include AICPA auditing publications not defined as interpretive publications; auditing articles in the *Journal of Accountancy* and other professional journals; continuing professional education programs and other instruction materials, textbooks, guidebooks, audit programs,

AU-C 200 Definitions of Terms

3

and checklists; and other auditing publications from state certified public accountant (CPA) societies, other organizations, and individuals.

Premise, relating to the responsibilities of management and, when appropriate, those charged with governance, on which an audit is conducted (the premise). Management and, when appropriate, those charged with governance have acknowledged and understand that they have the following responsibilities that are fundamental to the conduct of an audit in accordance with GAAS; that is, responsibility:

1. For the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework;
2. For the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; and
3. To provide the auditor with:
 - a. Access to all information of which management and, when appropriate, those charged with governance are aware that is relevant to the preparation and fair presentation of the financial statements, such as records, documentation, and other matters;
 - b. Additional information that the auditor may request from management and, when appropriate, those charged with governance for the purpose of the audit; and
 - c. Unrestricted access to persons within the entity from whom the auditor determines it necessary to obtain audit evidence.

The premise, relating to the responsibilities of management and, when appropriate, those charged with governance, on which an audit is conducted may also be referred to as the premise.

Professional judgment. The application of relevant training, knowledge, and experience within the context provided by auditing, accounting, and ethical standards in making informed decisions about the courses of action that are appropriate in the circumstances of the audit engagement.

Professional skepticism. An attitude that includes a questioning mind, being alert to conditions that may indicate possible misstatement due to fraud or error, and a critical assessment of audit evidence.

Reasonable assurance. In the context of an audit of financial statements, a high, but not absolute, level of assurance.

Risk of material misstatement. The risk that the financial statements are materially misstated prior to the audit. This consists of two components, described as follows at the assertion level:

- **Inherent risk.** The susceptibility of an assertion about a class of transaction, account balance, or disclosure to a misstatement that could be material, either individually or when aggregated with other misstatements, before consideration of any related controls.
- **Control risk.** The risk that a misstatement that could occur in an assertion about a class of transaction, account balance, or disclosure and that could be material, either individually or when aggregated with other misstatements, will not be prevented, or detected and corrected, on a timely basis by the entity's internal control.

Those charged with governance. The person(s) or organization(s) (for example, a corporate trustee) with responsibility for overseeing the strategic direction of the entity and the obligations related to the accountability of the entity. This includes overseeing the financial

4 **AU-C 200 Overall Objectives of the Independent Auditor . . .**

reporting process. Those charged with governance may include management personnel; for example, executive members of a governance board or an owner-manager.

OBJECTIVES OF AU-C SECTION 200

AU-C Section 200.12 states that:

. . . *the overall objectives of the auditor, in conducting an audit of financial statements, are to*

- a. obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are presented fairly, in all material respects, in accordance with an applicable financial reporting framework; and*
- b. report on the financial statements, and communicate as required by GAAS, in accordance with the auditor's findings.*

If reasonable assurance cannot be obtained and a qualified opinion is insufficient, the auditor must either disclaim an opinion or withdraw from the engagement when possible under applicable law or regulation. (AU-C 200.13)

REQUIREMENTS

MANAGEMENT'S RESPONSIBILITIES

Financial statements are prepared by management with oversight from those charged with governance. GAAS do not *impose* requirements on management or those charged with governance, but rather an audit is conducted on the premise that management and those charged with governance *understand* their responsibilities. (AU-C 200.05)

Many times clients do not understand their responsibilities for audited financial statements. The financial statements are *management's*. They contain management's representations. The form and content of the financial statements are management's responsibility, even if the auditor prepared them or participated in their preparation.

Management also is responsible for implementing and maintaining an effective system of internal control.

AUDITOR'S RESPONSIBILITIES

The auditor's responsibilities for the financial statements are confined to the expression of an opinion on the financial statements being audited. In performing the audit, the auditor is responsible for compliance with GAAS. Under GAAS, the auditor has a responsibility to consider AU-C sections and interpretive publications in all audits. If such guidance is not followed, an auditor must be prepared:

- For AU-C sections, to justify a departure from GAAS
- For interpretive publications, to explain that an alternative approach achieved the objectives of GAAS

To provide reasonable assurance that it is conforming with generally accepted auditing standards in its audit engagements, an accounting firm should establish quality control policies and procedures. These policies and procedures should apply not only to audit engagements but also to attest and accounting and review services for which professional standards have been established. (AU-C 200.A20) The AICPA's Quality Control Standards detail the firm's responsibility for

Requirements

5

establishing and maintaining a system of quality control for auditors. See QC Section 10, *A Firm's System of Quality Control*, for more information.

In every audit, the auditor has to obtain reasonable assurance¹ about whether the financial statements are free of material misstatement, whether due to errors or to fraud. (AU-C 200.06) Materiality is taken into account when planning and performing the audit. Misstatements are considered material, individually or in the aggregate, when they influence economic decisions made by financial statement users. Materiality considers qualitative and quantitative elements and should be viewed in context. (AU-C 200.07)

ETHICAL REQUIREMENTS

The auditor must be independent. If not independent, the auditor cannot issue a report under GAAS. The only exception is if GAAS provides otherwise or law or regulation requires the auditor to accept the engagement and report on the financial statements. (AU-C 200.15)

To *be* independent, the auditor must be intellectually honest; to be *recognized* as independent, he or she must be free from any obligation to or interest in the client, its management, or its owners. For specific guidance, the auditor should look to the AICPA and the state society codes of conduct and, if relevant, the requirements of the Securities and Exchange Commission (SEC).²

Policies and procedures should provide reasonable assurance that personnel maintain independence when required and perform all responsibilities with integrity, objectivity, and due care.

1. Independence is an impartiality that recognizes an obligation for fairness.
2. Integrity pertains to being honest and candid, and requires that service and public trust not be subordinated to personal gain.
3. Objectivity is a state of mind that imposes an obligation to be impartial, intellectually honest, and free of conflicts of interest.

Due care requires the auditor to discharge professional responsibilities with the competence and diligence necessary to perform the audit and issue an appropriate report and to render services promptly, thoroughly, and carefully, while observing applicable standards.

(See the AICPA's Code of Professional Conduct, Section 300.)

PROFESSIONAL SKEPTICISM AND JUDGMENT

The auditor must perform the audit with professional skepticism and exercise professional judgment in planning and performing an audit of financial statements. (AU-C 200.17-18) The auditor should:

- Observe GAAS,
- Possess the degree of skill commonly possessed by other auditors, and
- Exercise that skill with reasonable care and diligence.

¹ See *Definitions of Terms*.

² Section 201 of the Sarbanes-Oxley Act of 2002 and the related SEC implementing rules created significant new independence requirements for auditors of public companies. For example, the SEC prohibits certain nonaudit services such as bookkeeping, internal audit outsourcing, and valuation services. All audit and nonaudit services performed by the auditor, including tax services, must be preapproved by the company's audit committee. In March 2003, the SEC issued final rules implementing Section 201 of the Act. The rules, Strengthening the Commission's Requirements Regarding Auditor Independence, can be found at www.sec.gov/rules/final/33-8183.htm.

6 AU-C 200 Overall Objectives of the Independent Auditor . . .

The auditor should also exercise *professional skepticism*, that is, *an attitude that includes a questioning mind and a critical assessment of audit evidence*.

In practice, this means that auditors should be alert for:

- Contradictory evidence,
- Indications of fraud,
- Unusual circumstances,
- Evidence that calls into question the reliability of documents and responses to inquiries,
- The possibility of collusion when performing the audit, and
- How management may override controls in a way that would make the fraud particularly difficult to detect.

(AU-C 200.A22-A23)

However, the auditor is not an insurer, and the audit report does not constitute a guarantee. It is based on *reasonable assurance*. Thus, it is possible that an audit conducted in accordance with GAAS may not detect a material misstatement.

COMPLYING WITH GAAS

Auditors must comply with and understand AU-C sections. (AU-C 200.20 and .21) AU-C Section 200.25-26 clarifies that the SASs use two categories of professional requirements to describe the degree of responsibility the standards impose on auditors.

1. *Unconditional requirements*. The auditor is required to comply with an unconditional requirement in all cases in which the circumstances exist to which the unconditional requirement applies. SASs use the word *must* to indicate an unconditional requirement.
2. *Presumptively mandatory requirements*. The auditor is also required to comply with a presumptively mandatory requirement in all circumstances where the presumptively mandatory requirement exists and applies. However, in rare circumstances, the auditor may depart from a presumptively mandatory requirement. The departure should only relate to a specific procedure when the auditors determine that the procedure would be ineffective in the specific circumstances. The auditors must document their justification for the departure and how the alternative procedures performed in the circumstances were sufficient to achieve the objectives of the presumptively mandatory requirement. GAAS use the word *should* to indicate a presumptively mandatory requirement.

(AU-C 200.25-.26)

The term *should consider* means that the consideration of the procedure or action is presumptively required, whereas carrying out the procedure or action is not.

AU-C Section 200 also clarifies that explanatory material is intended to explain the objective of the professional requirements, rather than imposing a professional requirement for the auditor to perform.

GAAS AND THE GAAS HIERARCHY

The auditor is responsible for planning, conducting, and reporting the results of an audit according to GAAS.³ GAAS provide the standards for the auditors' work in fulfilling their

³ *Generally accepted auditing standards are issued in the form of Statements on Auditing Standards and codified into AU-C sections in the AICPA's Professional Standards.*

Complying with GAAS

7

objectives. Each AU-C section contains objectives that provide a link between the requirements and the overall objectives of the auditors. Auditors should have sufficient knowledge of the AU-C sections to determine when they apply and should be prepared to justify departures from them.

Interpretive Publications

Interpretive publications are not auditing standards, but are recommendations, issued under the authority of the ASB, on how to apply the SASs in specific circumstances, including engagements for entities in specialized industries. Interpretive publications are not auditing standards. They consist of the following:

- Auditing Interpretations of SASs, listed in each chapter of this book that has a related Interpretation.
- AICPA Audit and Accounting Guides and Statements of Position, listed in Appendix B of this book.

(AU-C 200.A81)

Auditors should consider interpretive publications that apply to their audits.

Other Auditing Publications

Other auditing publications, listed in Appendix C of this book, are not authoritative but may help auditors to understand and apply SASs. An auditor should evaluate such guidance to determine whether it is both (1) *relevant* for a particular engagement and (2) *appropriate* for the particular situation. When evaluating whether the guidance is appropriate, the auditor should consider whether the publication is recognized as helpful in understanding and applying SASs, and whether the author is recognized as an auditing authority. AICPA auditing publications that have been reviewed by the AICPA Audit and Attest Standards staff are presumed to be appropriate. (AU-C 200.A84)

Wiley Practitioner's Guide to GAAS 2018: Covering All SASs, SSAEs, SSARs, and Interpretations
© 2018 John Wiley & Sons, Inc. Published 2018 by John Wiley & Sons, Inc.

AU-C 210 Terms of Engagement

AU-C ORIGINAL PRONOUNCEMENT

Source Statement on Auditing Standards (SAS) 122.

APPLICABILITY

This section states the requirements and provides application guidance on the auditor's responsibilities in agreeing upon terms of engagement with management and those charged with governance. It establishes preconditions for an audit, for which management is responsible. AU-C 220, *Quality Control for an Engagement Conducted in Accordance with Generally Accepted Auditing Standards*, addresses those aspects of engagement acceptance that the auditor can control. AU-C 580, *Written Representations*, discusses management's responsibilities. (AU-C 210.01)

AU-C 210 DEFINITIONS OF TERMS

Source: *AU-C 210.04*

Preconditions for an audit. The use by management of an acceptable financial reporting framework in the preparation and fair presentation of the financial statements and the agreement of management and, when appropriate, those charged with governance, to the premise on which an audit is conducted.

Recurring audit. An audit engagement for an existing audit client for whom the auditor performed the preceding audit.

OBJECTIVES OF AU-C SECTION 210

AU-C Section 210.03 states that:

. . . the objective of the auditor is to accept an audit engagement for a new or existing audit client only when the basis upon which it is to be performed has been agreed upon through

- a. establishing whether the preconditions for an audit are present and*
- b. confirming that a common understanding of the terms of the audit engagement exists between the auditor and management and, when appropriate, those charged with governance.*

FUNDAMENTAL REQUIREMENTS

ENGAGEMENT ACCEPTANCE**Preconditions**

Unless required to do so by law or regulation, an auditor should not accept an engagement when the preconditions (see “Definitions of Terms” section above) are not met. (AU-C 210.08) To assess whether those preconditions are met, the auditor should:

- a. determine whether the financial reporting framework¹ *to be applied in the preparation of the financial statements is acceptable and*
- b. *obtain the agreement of management that it acknowledges and understands its responsibility*
 - i. *for the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework;*
 - ii. *for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; and*
 - iii. *to provide the auditor with*
 1. *access to all information of which management is aware that is relevant to the preparation and fair presentation of the financial statements, such as records, documentation, and other matters;*
 2. *additional information that the auditor may request from management for the purpose of the audit; and*
 3. *unrestricted access to persons within the entity from whom the auditor determines it necessary to obtain audit evidence.*

(AU-C 210.06)

Limitation of Scope

If management limits the scope of the auditor’s work so that the auditor will have to disclaim an opinion, the auditor should not accept the engagement. The exception to this is when management is required by law or regulation to have an audit and the disclaimer of opinion is acceptable under law or regulation, for example with audits of employee benefit plans. Then the auditor can accept the engagement, but is not required to do so. (AU-C 210.07)

Agreement on Terms

The auditor should establish an understanding with management or those charged with governance² about the services to be performed for each audit, review of a public company’s

¹ *Acceptable reporting frameworks contain established accounting principles promulgated by a body designated by the Council of the AICPA under Rule 203 in the AICPA Code of Professional Conduct. These bodies include FASB, FASAB, IFRS, GASB, AICPA, and PCAOB.*

² *In this chapter, references to management should be read as “management and, when appropriate, those charged with governance,” unless the context suggests otherwise. Those charged with governance are those “with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity,” including the financial reporting process. (AU-C Glossary of Terms)*

Fundamental Requirements

11

financial statements, or agreed-upon procedures engagement. The understanding should include:

1. The engagement's objectives and scope
2. Management's responsibilities
3. Auditor's responsibilities
4. The audit's limitations, the inherent limitations of internal control, and the risk that some misstatements may not be detected
5. Financial reporting framework
6. Expected form and content of the report

In addition, the auditor may want to:

- Elaborate on the scope of the audit by referencing regulations, laws, GAAS, ethical codes, and pronouncements of professional bodies, as applicable.
- Identify any communications in addition to the auditor's report.
- Discuss audit planning and performance, including composition of the audit team.
- Remind management about the expectation of written representation, the agreement to make available draft financial statements on a timely basis, and the agreement for management to inform the auditor of subsequent events or facts discovered after the date of the financial statements that may affect the financial statements.
- Detail fees and billing arrangements.
- Request management to acknowledge receipt of the engagement letter and to agree to the terms by signing the letter.

The auditor may also choose to address arrangements concerning the involvement of other auditors, specialists, internal auditors and other entity staff, and predecessor auditors. Restrictions on auditor's liability, when not prohibited; audit documentation to be provided to other parties; additional services; arrangements with component auditors; and any other agreements with the entity may be included in the engagement letter. (AU-C 210.A23-.A26)

The auditor should document the understanding in writing. If the auditor fails to establish an understanding, the auditor should decline the engagement. (AU-C 210.09-.10) A sample engagement letter is included at the end of this chapter.

Initial Audits, Including Reaudits

Inquiry of the predecessor auditor is required because the predecessor may provide information that will assist the successor auditor in deciding whether to accept the engagement. The communication may be either written or oral. Both the predecessor and successor auditors should treat any information obtained from each other as confidential information. The successor auditor should request permission from the prospective client to make an inquiry of the predecessor *prior to final acceptance of the engagement*. However, the successor auditor may make a proposal for an audit engagement before having permission to inquire of the predecessor auditor.

The successor auditor should ask the prospective client to authorize the predecessor to respond fully to the successor auditor's inquiries. If a prospective client refuses to permit the predecessor auditor to respond or limits the response, the successor auditor should inquire as to the reasons and consider the implications of that refusal in deciding whether to accept the

AU-C 210 Terms of Engagement

engagement. (AU-C 210.11) The successor auditor should make specific and reasonable inquiries of the predecessor about the following four matters:

1. Information about management's integrity
2. Disagreements with management about accounting principles, auditing procedures, or other significant matters
3. Communications to those charged with governance and responsibility regarding fraud, noncompliance with laws or regulations, and matters related to internal control
4. The predecessor auditor's understanding of the reasons for the change of auditors (AU-C 210.A31)

The predecessor auditor should respond promptly, fully, and factually. However, if the predecessor decides, due to unusual circumstances such as impending, threatened, or potential litigation; disciplinary proceedings; or other unusual circumstances, not to respond fully, he or she should indicate that the response is limited. Also, if more than one auditor is considering accepting the audit, the predecessor auditor does not have to respond to inquiries until an auditor has been selected by the entity and has accepted the engagement. Any information exchanged between the predecessor and successor auditors should be considered confidential. (AU-C 210.A28-A30)

If the successor auditor receives a limited response, that auditor should consider the implications of the limited response in deciding whether to accept the engagement.

Recurring Audits

For a recurring audit, the auditor should evaluate whether the terms of the engagement need to be changed. The auditor should also remind the client about the existing terms of engagement.

Change in Terms

If the client requests a change in the terms, the auditor must ensure that there is a reasonable justification for the change. So, too, if prior to completion of an audit, the client requests a change to an engagement with a lower level of assurance, the auditor must be satisfied that a reasonable justification for doing so exists.

Certain factors may warrant a change in the terms of engagement for a recurring engagement. These might include, for example, changes in management or ownership, in legal or regulatory requirements, in the size of the entity, or in the financial reporting framework. (AU-C 210.A33) If the terms are changed, the auditor and management should document in writing the mutually agreed-upon change. (AU-C 210.13-16) If, however, the auditor concludes there is no reasonable justification for a change in terms, and management does not allow the auditor to continue the original audit, the auditor must take these three steps:

1. Withdraw from the engagement.
2. Communicate the situation to those charged with governance.
3. Determine whether the auditor has any legal, contractual, or other obligation to report the circumstances to owners, regulators, or other parties. (AU-C 210.17)

ILLUSTRATION**ILLUSTRATION 1. EXAMPLE OF AN AUDIT ENGAGEMENT LETTER (FROM AU-C 210.A42)**

<p>The following is an example of an audit engagement letter for an audit of general purpose financial statements prepared in accordance with US GAAP. This letter is intended only to be a guide that may be used in conjunction with the considerations outlined in AU-C Section 210. The letter will vary according to individual requirements and circumstances and is drafted to refer to the audit of financial statements for a single reporting period. The auditor may seek legal advice about whether a proposed letter is suitable.</p>	
<i>Auditor's letterhead</i>	<p>Smith and Jones Certified Public Accountants October 7, 20XX</p>
<i>Addressed to the appropriate representative of those charged with governance</i>	<p>Brock Warner Plainsmen, Inc. 2320 Tiger Blvd. Lancaster, PA 19701</p>
<i>The objective and scope of the audit</i>	<p>You have requested that we audit the financial statements of Plainsmen, Inc., which comprise the balance sheet as of December 31, 20XX, and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements. We are pleased to confirm our acceptance and our understanding of this audit engagement by means of this letter. Our audit will be conducted with the objective of our expressing an opinion on the financial statements.</p>
<i>The responsibilities of the auditor</i>	<p>We will conduct our audit in accordance with auditing standards generally accepted in the United States of America (GAAS). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or to error. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.</p> <p>Because of the inherent limitations of an audit, together with the inherent limitations of internal control, an unavoidable risk exists that some material misstatements may not be detected, even though the audit is properly planned and performed in accordance with GAAS.</p> <p>In making our risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. However, we will communicate to you in writing concerning any significant deficiencies or material weaknesses in internal control relevant to the audit of the financial statements that we have identified during the audit.</p>

AU-C 210 Terms of Engagement

<p><i>The responsibilities of management and identification of the applicable financial reporting framework</i></p>	<p>Our audit will be conducted on the basis that <i>[management and, when appropriate, those charged with governance]</i> acknowledge and understand that they have responsibility:</p> <ol style="list-style-type: none"> 1. For the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America; 2. For the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or to error; and 3. To provide us with: <ol style="list-style-type: none"> a. Access to all information of which <i>[management]</i> is aware that is relevant to the preparation and fair presentation of the financial statements such as records, documentation, and other matters; b. Additional information that we may request from <i>[management]</i> for the purpose of the audit; and c. Unrestricted access to persons within the entity from whom we determine it necessary to obtain audit evidence. <p>As part of our audit process, we will request from <i>[management and, when appropriate, those charged with governance]</i> written confirmation concerning representations made to us in connection with the audit.</p>
<p><i>Other relevant information:</i></p>	
<p><i>Insert other information, such as fee arrangements, billings, and other specific terms, as appropriate.</i></p>	
<p><i>Reporting</i></p>	<p><i>[Insert appropriate reference to the expected form and content of the auditor's report. Example follows:]</i></p> <p>We will issue a written report upon completion of our audit of Plainsmen, Inc.'s financial statements. Our report will be addressed to the board of directors of Plainsmen, Inc. We cannot provide assurance that an unmodified opinion will be expressed. Circumstances may arise in which it is necessary for us to modify our opinion, add an emphasis-of-matter or other-matter paragraph(s), or withdraw from the engagement.</p> <p>We also will issue a written report on <i>[insert appropriate reference to other auditors' reports expected to be issued]</i> upon completion of our audit.</p>
<p><i>Signed Name and Title Date</i></p>	<p>Please sign and return the attached copy of this letter to indicate your acknowledgment of, and agreement with, the arrangements for our audit of the financial statements including our respective responsibilities.</p> <p>Smith and Jones.</p> <p>Acknowledged and agreed on behalf of Plainsmen, Inc. by</p> <p>_____</p>

Wiley Practitioner's Guide to GAAS 2018: Covering All SASs, SSAEs, SSARs, and Interpretations
© 2018 John Wiley & Sons, Inc. Published 2018 by John Wiley & Sons, Inc.

AU-C 220 Quality Control for an Engagement Conducted in Accordance with Generally Accepted Auditing Standards

AU-C ORIGINAL PRONOUNCEMENTS

Sources Statements on Auditing Standards (SASs) 122 and 128.

APPLICABILITY

AU-C 220 addresses specific responsibilities of the auditor regarding quality control standards for an audit of financial statements. Quality control is the responsibility of the audit firm. AU-C 220 also addresses supervision of an audit.

AU-C 220 DEFINITIONS OF TERMS

Source: AU-C 220.09

Engagement partner. The partner or other person in the firm who is responsible for the audit engagement and its performance and for the auditor's report issued on behalf of the firm and who, when required, has the appropriate authority from a professional, legal, or regulatory body.

Engagement quality control review. A process designed to provide an objective evaluation, before the report is released, of the significant judgments the engagement team made and the conclusions it reached in formulating the auditor's report. The engagement quality control review process is only for those audit engagements, if any, for which the firm has determined that an engagement quality control review is required, in accordance with its policies and procedures.

Engagement quality control reviewer. A partner, other person in the firm, suitably qualified external person, or team made up of such individuals, none of whom is part of the engagement team, with sufficient and appropriate experience and authority to objectively evaluate the significant judgments that the engagement team made and the conclusions it reached in formulating the auditor's report.

Engagement team. All partners and staff performing the engagement and any individuals engaged by the firm or a network firm who perform audit procedures on the engagement. This excludes an auditor's external specialist engaged by the firm or a network firm.

AU-C 220 Quality Control for an Engagement Conducted . . .

The term *engagement team* also excludes individuals within the client's internal audit function who provide direct assistance on an audit engagement when the external auditor complies with the requirements of Section 610, *Using the Work of Internal Auditors*.¹

Firm. A form of organization permitted by law or regulation whose characteristics conform to resolutions of the Council of the AICPA and which is engaged in the practice of public accounting.

Monitoring. A process comprising an ongoing consideration and evaluation of the firm's system of quality control, including inspection or a periodic review of engagement documentation, reports, and clients' financial statements for a selection of completed engagements, designed to provide the firm with reasonable assurance that its system of quality control is designed appropriately and operating effectively.

Network. An association of entities, as defined in ET Section 92, *Definitions*.

Network firm. A firm or other entity that belongs to a network, as defined in ET Section 92.

Partner. Any individual with authority to bind the firm with respect to the performance of a professional services engagement. For purposes of this definition, *partner* may include an employee with this authority who has not assumed the risks and benefits of ownership. Firms may use different titles to refer to individuals with this authority.

Personnel. Partners and staff.

Professional standards. Standards promulgated by the AICPA Auditing Standards Board or the AICPA Accounting and Review Services Committee under Rule 201, *General Standards* (ET sec. 201 par. .01), or Rule 202, *Compliance with Standards* (ET sec. 202 par. .01), of the AICPA Code of Professional Conduct, or other standards-setting bodies that set auditing and attest standards applicable to the engagement being performed and relevant ethical requirements.

Relevant ethical requirements. Ethical requirements to which the engagement team and engagement quality control reviewer are subject, which consist of the AICPA Code of Professional Conduct together with rules of applicable state boards of accountancy and applicable regulatory agencies that are more restrictive.

Staff. Professionals, other than partners, including any specialists that the firm employs.

Suitably qualified external person. An individual outside the firm with the competence and capabilities to act as an engagement partner (for example, a partner of another firm).

OBJECTIVE OF AU-C SECTION 220

AU-C Section 220.08 states that:

. . . the objective of the auditor is to implement quality control procedures at the engagement level that provide the auditor with reasonable assurance that

- a. the audit complies with professional standards and applicable legal and regulatory requirements and*
- b. the auditor's report issued is appropriate in the circumstances.*

¹ This paragraph was added by SAS No. 128.

REQUIREMENTS

QUALITY CONTROL STANDARDS

The engagement partner is responsible for the overall quality of the engagements to which the partner is assigned. An audit firm should establish a quality control system to provide it with reasonable assurance that its staff meets the requirements of professional standards and applicable legal and regulatory requirements and that reports are appropriate. (AC 220.03) The proper staff can make the difference between an effective, efficient audit and one that is wasteful and has poor results.

SYSTEM OF QUALITY CONTROL

The nature and extent of a firm's quality control policies and procedures depend on the following five factors:

1. Firm size and the number of its offices
2. The degree of autonomy of personnel and practice offices
3. The knowledge and experience of its personnel
4. The nature and complexity of the firm's practice
5. The cost of developing and implementing quality control policies and procedures in relation to the benefits provided

When a firm establishes quality control policies and procedures, it should do the following:

1. Assign responsibilities to qualified personnel to implement quality control policies and procedures.
2. Communicate quality control policies and procedures to personnel (see below).
3. Monitor the effectiveness of the quality control system. The purpose is to determine that policies and procedures and the methods of implementing and communicating them are still appropriate.

NOTE: Flaws in, or a violation of, a firm's quality control do not necessarily indicate that an audit was not performed in accordance with GAAS.

ELEMENTS OF QUALITY CONTROL

When establishing its quality control policies and procedures, a firm should consider the elements of quality control:

- Leadership responsibilities for quality
- Ethical requirements
- Acceptance and continuance of clients
- Assignment of engagement terms
- Engagement performance
- Monitoring

NOTE: CPA firms or individuals that are enrolled in an AICPA-approved practice-monitoring program are obligated to adhere to quality control standards. In addition, the Principles of Professional Conduct indicate that members should practice in firms that have in place quality control procedures to provide reasonable assurance that services are competently delivered and adequately supervised. The Statements on Quality Control apply to a CPA firm's accounting, auditing, and attest practices.

18 **AU-C 220 Quality Control for an Engagement Conducted . . .****INDEPENDENCE²**

The engagement partner is responsible for the independence requirements for each audit and ensuring that these requirements are met. The engagement partner should:

- Evaluate the threats to independence,
- Evaluate any breaches, and
- Take appropriate action to eliminate or reduce threats to an appropriate level. If that cannot be done, the firm may have to withdraw from the engagement. (AU-C 220.13)

To *be* independent, auditors must be intellectually honest; to be *recognized* as independent, they must be free from any obligation to or interest in the client, its management, or its owners. For specific guidance, the auditor should look to AICPA and the state society codes of conduct and, if relevant, the requirements of the Securities and Exchange Commission (SEC).

ACCEPTANCE AND CONTINUANCE OF CLIENT RELATIONSHIPS

The engagement partner must be satisfied that appropriate procedures regarding acceptance and continuance of clients have been performed and that appropriate conclusions were reached. (AU-C 220.14)

Policies and procedures should provide reasonable assurance that the firm will not be associated with clients whose management lacks integrity. A firm should:

- Undertake only engagements that can be completed with professional competence,
- Consider the client's integrity,
- Ensure that ethical requirements can be met, and
- Evaluate significant issues during current or previous audits and their implications for continuance.

(AU-C 220.A7)

ASSIGNMENT OF ENGAGEMENT TEAMS

The engagement partner must be comfortable that the engagement team and external specialists are capable and have the appropriate competencies. (AU-C 220.16)

Direction, Supervision, and Performance

The engagement partner is responsible for the direction, supervision, and performance of the engagement with compliance with GAAS and the appropriateness of the report, performance of reviews, and that sufficient appropriate evidence has been obtained. (AU-C220.17)

The auditor with final responsibility for the audit should inform members of the engagement team about:

- Their responsibilities
- The responsibilities of the partners

² *Section 201 of the Sarbanes-Oxley Act of 2002 and the related SEC implementing rules contain significant independence requirements for auditors of public companies. For example, the SEC prohibits certain nonaudit services such as bookkeeping, internal audit outsourcing, and valuation services. All audit and nonaudit services performed by the auditor, including tax services, must be preapproved by the company's audit committee. In March 2003, the SEC issued final rules implementing Section 201 of the Act. The rules, Strengthening the Commission's Requirements Regarding Auditor Independence, can be found at www.sec.gov/rules/final/33-8183.htm.*

Requirements

19

- The objectives of the procedures they are to perform
- Aspects of the entity's business relevant to their assignment
- Risk-related issues
- Problems that may arise
- Details of the approach to the engagement

(AU-C 220.A12)

Supervision includes:

- Tracking the engagement progress
- Considering the competence of engagement team members
- Addressing significant findings or issues
- Identifying matters for consultation or referral to other team members

(AU-C 220.A13)

ENGAGEMENT PERFORMANCE

Reviewing Work

The engagement partners are responsible for the reviews following the firm's policies and procedures. In order to be sure that they are satisfied that the audit audience is sufficient and appropriate to support the conclusion, the engagement partners should review the audit documentation and discuss the engagement with the auditor. Then, this should be done on or before the date of the auditor's report. (AU-C 220.18-19) It is important that the partner review the documentation and not just rely on staff opinions.

The suitably experienced auditors should review the work of each team member and consider if:

1. The work was performed in accordance with professional standards and legal and regulatory requirements.
2. Significant issues were raised and considered.
3. Consultations, if necessary, took place and were documented.
4. The nature, timing, and extent of the work were appropriate.
5. Work performed supports the conclusion and is documented, and the evidence supports the auditor's report.
6. Objectives were achieved.

(AU-C 220.A16)

The engagement partner's review should allow time to resolve issues. (AU-C 220.A17)

Difference of Opinion

If differences of opinion arise among firm personnel about accounting or auditing issues in an audit, there should be:

1. Consultation to attempt resolution
2. Documentation of an assistant's disagreement, if he or she wants to be disassociated from the final resolution
3. Documentation of the basis for the final resolution

(AU-C 220.A23)