Accounting and Auditing Update

(AAU4)

KAPLAN

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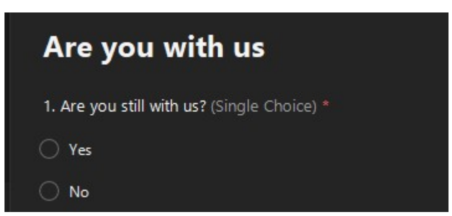

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- **Once you are logged in please do not log out even during breaks.**

Unit 1

FASB Update

Learning Objectives

- Apply recently issued Accounting Standard Updates (ASUs)

FASB's Technical Agenda

1. Recognition and Measurements
2. Presentation and Disclosure Projects
3. Framework Projects
4. Research Projects
5. Post-Implementation Projects

FASB's Effective Dates

- Public companies
- Non-public companies

FASB Update – 2023

ASU 2016-13, Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments

ASU 2016-13, Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments, was issued to provide financial statement users with more decision-useful information about a reporting entity's:

1. Expected credit losses on financial assets and
2. Other commitments to extend credit

FASB Update – 2023

ASU 2016-13, Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments (cont'd)

Scope of Topic 326 includes:

- Loans receivable
- Debt securities
- Trade receivables
- Net investment in leases
- Off-balance sheet credit exposure
- Reinsurance receivables

FASB Update – 2023

ASU 2016-13, Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments (cont'd)

- Financial assets measured at amortized cost and certain other financial instruments
  - CECL
- Available-for-sale debt securities
- Topic 326 disclosures

FASB Update – 2023

Implementation Considerations of ASU 2016-13—Credit Losses

- It impacts any entity that has financial assets not measured at fair value (measured at amortized cost) with the right to receive cash
- Modifies the existing credit risk model
- Reporting entities that provide extended customer payment
- Non-financial indicators
- Legacy trade receivable expected losses based on the aging method may need to be modified

FASB Update – 2023

Implementation Considerations of ASU 2016-13—Credit Losses (cont'd)

- Modify accounting policies, processes, and controls
- Determine whether enterprise and information technology systems need to be changed
- Determine any secondary impact on other company functions such as human resources for incentive compensation, debt covenant compliance, and income taxes
- Disclosures will most likely increase due to the greater judgment of forecasting inputs and conclusions

FASB Update – 2023

ASU 2022-01, Fair Value Hedging-Portfolio Layer Method: Derivatives and Hedging (Topic 815)

Objective:

- ASU 2022-01 updates ASU 2017-12, Targeted Improvements to Accounting for Hedging Activities (Topic 815) by providing expanded optional hedge accounting guidance to better reflect the effects of risk management activities in the financial statements and ultimately provide investors and other allocators of capital with more transparent, decision-useful information around a reporting entity's use of derivatives

FASB Update – 2023

ASU 2022-01, Fair Value Hedging-Portfolio Layer Method: Derivatives and Hedging (Topic 815) (cont'd)

- ASU 2022-01 expands the scope of ASU 2017-12 to allow reporting entities to apply the portfolio layer method (referred to previously as last-of-layer) to portfolios of all financial assets, including both prepayable and non-prepayable financial assets
- ASU 2022-01 allows reporting entities to designate multiple layers in a single portfolio as individual hedged items
  - This permits reporting entities to designate multiple hedging relationships with a single closed portfolio enabling a larger portion of the interest rate risk associated with the portfolio to be hedged

FASB Update – 2023

ASU 2022-01, Fair Value Hedging-Portfolio Layer Method: Derivatives and Hedging (Topic 815) (cont'd)

- ASU 2022-01 also indicates that if the aggregate amount of the hedged layers is no longer anticipated to be outstanding in future hedged periods (a breach is anticipated), a reporting entity is required to partially or fully de-designate a hedged layer or layers until a breach is no longer anticipated

FASB Update – 2023

ASU 2022-01, Fair Value Hedging-Portfolio Layer Method: Derivatives and Hedging (Topic 815) (cont'd)

ASU 2022-01 also provides accounting guidance for hedge basis adjustments under the portfolio layer method - this guidance includes the following:

- A reporting entity is required to maintain basis adjustments in an existing hedge in a closed portfolio – not allocated to individual assets
- A reporting entity is required to immediately recognize and present the basis adjustment associated with the amount of the de-designated layer that was breached in interest income. In addition, the reporting entity is required to disclose the amount and the circumstances that led to the breach
- A reporting entity is required to disclose the total amount of the basis adjustments in existing hedges as a reconciling amount if other areas of GAAP require the disaggregation disclosure of the amortized cost basis of assets included in the closed portfolio
- A reporting entity is prohibited from considering basis adjustments in an existing hedge when determining credit losses

FASB Update – 2023

ASU 2022-01, Fair Value Hedging-Portfolio Layer Method: Derivatives and Hedging (Topic 815) (cont'd)

- EXAMPLE

FASB Update – 2023

ASU 2022-02, Troubled Debt Restructurings and Vintage Disclosures: Financial Instruments-Credit Losses (Topic 326)

Objective:

- ASU 2022-02 is intended to improve the decision usefulness of information provided to investors about certain loan re-financings, restructurings, and write-offs
- ASU 2022-02 creates a single model for loan modification accounting by creditors while providing improved loan modification and write-off disclosures

FASB Update – 2023

ASU 2022-02, Troubled Debt Restructurings and Vintage Disclosures: Financial Instruments-Credit Losses (Topic 326) (cont'd)

- ASU 2022-02 eliminates the accounting guidance for troubled debt restructurings in Subtopic 310-40 by creditors that have adopted CECL (Topic 326, Financial Instruments-Credit Losses) while enhancing disclosure requirements for certain loan re-financings and restructurings by creditors made to borrowers experiencing financial difficulty
- Rather than applying the recognition and measurement guidance for TDRs, a reporting entity must apply the loan refinancing and restructuring guidance in Subtopics 310-20-35-9 through 11 to determine whether a modification results in a new loan or a continuation of an existing loan

FASB Update – 2023

ASU 2022-02, Troubled Debt Restructurings and Vintage Disclosures: Financial Instruments-Credit Losses (Topic 326) (cont'd)

- Under ASU 2022-02, a reporting entity is no longer required to use a DCF method to measure the allowance for credit losses as a result of a modification or restructuring with a borrower experiencing financial difficulty

FASB Update – 2023

ASU 2022-02, Troubled Debt Restructurings and Vintage Disclosures: Financial Instruments-Credit Losses (Topic 326) (cont'd)

- ASU 2022-02 requires that a public business entity disclose current period write-offs by year of origination for financing receivables and net investment in leases
  - This disclosure should include each of the previous five annual fiscal periods starting with the date of the financial statements and for the annual periods before that
  - Upon adoption of ASU 2022-02, a reporting entity would not provide the previous five annual fiscal periods of gross write-offs but instead be provided on a prospective basis allowing the reporting entity to build the five annual fiscal period disclosure over time

FASB Update – 2023

ASU 2022-02, Troubled Debt Restructurings and Vintage Disclosures: Financial Instruments-Credit Losses (Topic 326) (cont'd)

Disclosures:

- Modification to Debtors Experiencing Financial Difficulty
- Vintage Disclosures-Gross Write-offs

FASB Update – 2023

ASU 2022-03, Fair Value Measurement of Equity Securities Subject to Contractual Sales Restrictions (Topic 820)

Objective:

- To clarify the guidance in Topic 820, Fair Value Measurement, when measuring the fair value of an equity security subject to contractual restrictions that prohibit the sale of the equity security
- To amend a related illustrative example
- To introduce new disclosure requirements for equity securities subject to contractual sale restrictions that are measured at fair value

FASB Update – 2023

ASU 2022-03, Fair Value Measurement of Equity Securities Subject to Contractual Sales Restrictions (Topic 820) (cont'd)

- ASU 2022-03 clarifies that a contractual restriction on the sale of an equity security is not considered part of the unit of account of the equity security and, therefore, is not considered in measuring fair value
- ASU 2022-03 also clarifies that a reporting entity cannot, as a separate unit of account, recognize and measure a contractual sale restriction
- Unit of account is defined by FASB as "The level at which an asset or a liability is aggregated or disaggregated in a Topic for recognition purposes."

FASB Update – 2023

ASU 2022-03, Fair Value Measurement of Equity Securities Subject to Contractual Sales Restrictions (Topic 820) (cont'd)

Disclosures:

- For equity securities subject to contractual sales restrictions:
- The fair value of equity securities subject to contractual sale restrictions reflected in the balance sheet
- The nature and remaining duration of the restriction(s)
- The circumstances that could cause a lapse in the restriction(s)

FASB Update – 2023

ASU 2022-04, Disclosure of Supplier Finance Program Obligations (Subtopic 405-50)

Objective:

- The objective of ASU 2022-04 is for a reporting entity to disclose sufficient information to enable users of financial statements to understand the nature, activity during the period, changes from period to period, and potential magnitude of the entity's supplier finance programs
- To achieve that objective, a reporting entity should disclose qualitative and quantitative information about its supplier finance programs

FASB Update – 2023

ASU 2022-04, Disclosure of Supplier Finance Program Obligations (Subtopic 405-50) (cont'd)

In each annual reporting period, the buyer should disclose the following information:

- The key terms of the program, including a description of the payment terms (including payment timing and basis for its determination) and assets pledged as security or other forms of guarantees provided fore the committed payment to the finance provider or intermediary
- For the obligations that the buyer has confirmed as valid to the finance provider or intermediary:
    1. The amount outstanding that remains unpaid by the buyer as of the end of the annual period (the outstanding confirmed amount)
    2. A description of where those obligations are presented in the balance sheet
    3. A rollforward of those obligations during the annual period, including the amount of obligations confirmed and the amount of obligations subsequently paid

FASB Update – 2023

ASU 2022-05, Transition for Sold Contracts (Topic 944-Financial Services-Insurance)

Objective:

- Reduce implementation costs and complexity associated with the adoption of ASU 2018-12, Financial Services-Insurance (Topic 944): Targeted Improvements to the Accounting for Long-Duration Contracts (LDTI), for contracts that have been derecognized before the LDTI effective date
- As noted in ASU 2022-05, without the amendments in this Update, an insurance entity would be required to reclassify a portion of the previously recognized gains or losses to the LDTI transition adjustment because of the adoption of a new accounting standard
  - Because there is no effect on an insurance entity's future cash flows, such a reclassification may not be decision useful to investors and other allocators of capital

FASB Update – 2023

ASU 2022-05, Transition for Sold Contracts (Topic 944-Financial Services-Insurance) (cont'd)

- ASU 2022-05 amend the LDTI transition guidance to allow an insurance entity to make an accounting policy election on a transaction-by-transaction basis
- An insurance entity may elect to exclude contracts that meet certain criteria from applying ASU 2018-12, Targeted Improvements to the Accounting for Long-Duration Contracts

To qualify for the accounting policy election, as of the LDTI effective date both of the following conditions must be met:

- The insurance contracts must have been derecognized because of a sale or disposal of individual or a group of contracts or legal entities
- The entity has no significant continuing involvement with the derecognized contracts

FASB Update – 2023

ASU 2022-06, Reference Rate Reform (Topic 848): Deferral of the Sunset Date of Topic 848

Objective:

- The objective of the guidance in Topic 848 is to provide temporary relief associated with reference rate reform as a result of transiting from LIBOR to The Secured Overnight Financing Rate (SOFR) in 2023

FASB Update – 2023

ASU 2022-06, Reference Rate Reform (Topic 848): Deferral of the Sunset Date of Topic 848

Provision:

- In March 2021, the UK Financial Conduct Authority (FCA) announced that the intended cessation date of the overnight 1-, 3-, 6-, and 12-month tenors of USD LIBOR would be June 30, 2023, which is beyond the current sunset date of Topic 848
- Because the current relief in Topic 848 may not cover a period of time during which a significant number of modifications may take place, the amendments in ASU 2022-06 defer the sunset date of Topic 848 from December 31, 2022, to December 31, 2024, after which entities will no longer be permitted to apply the relief in Topic 848

AICPA Technical Questions and Answers (TQAs) in Accounting

- Consolidated Versus Combined Financial Statements
- Disclosure Concerning Subsequent Events in Special Purpose Financial Statements
- Applicability of Fair Value Disclosure Requirements and Measurement Principles in FASB Accounting Standards Codification (ASC) 820, Fair Value Measurement, to Certain Financial Instruments
- Accounting for Certain Liquidated Damages

FASB Project – Accounting for and Disclosure of Crypto Assets

- The purpose of this FASB project is to establish accounting guidance for companies and NFPs that hold crypto currencies
- Currently, FASB's guidance treats crypto currencies as indefinite-lived intangible assets recorded at their cost to acquire them with subsequent measurement at their impaired value (if any) with no provisions to recognize market gains on these currencies
- Definition

FASB Project – Accounting for and Disclosure of Crypto Assets

FASB Board Meeting

FASB decided that crypto assets that are held by an entity must meet the following criteria to be within the project's scope:

- Meet the definition of an intangible asset as defined in the FASB Codification
- Do not provide the asset holder with enforceable rights to, or claims on, underlying goods, services, or other assets
- Are created or reside on a distributed ledger or blockchain
- Are secured through cryptography
- Are fungible (something (such as money or a commodity) of such a nature that one part or quantity may be replaced by another equal part or quantity in paying a debt or settling an account (Merriam-Webster)

FASB Project – Accounting for and Disclosure of Crypto Assets

FASB Board Meeting (cont'd)

The Board decided to require an entity to:

1. At a minimum, present the aggregate amount of crypto assets (within the scope of this project) separately from other intangible assets that are measured using other measurement bases
2. Present gains and losses on crypto assets (within the scope of this project) in net income and present those gains and losses separately from the income statement effects of other intangible assets, such as amortization or impairments
3. Classify crypto assets received as noncash consideration during the ordinary course of business that are converted nearly immediately into cash as operating cash flows

FASB Project – Accounting for and Disclosure of Crypto Assets

FASB Board Meeting (cont'd)

The Board decided to require an entity to (cont'd):

4. These presentation requirements would be applicable to all entities, including public and private entities. The Board also decided that investment companies and not-for-profit entities should present their financial statements in accordance with the presentation requirements in Topic 946, Financial Services—Investment Companies, and Topic 958, Not-for-Profit Entities, respectively, subject to minor amendments that would clarify the inclusion of crypto assets
5. The Board affirmed that disclosures in Topic 820, Fair Value Measurement, would be required for crypto assets within the scope of this project. Those disclosures would be required in annual and interim periods, consistent with the existing requirements in Topic 820

FASB Project – Accounting for and Disclosure of Crypto Assets

FASB Board Meeting (cont'd)

The Board also decided to require an entity to disclose the following:

1. At both annual and interim periods, the following information about each significant crypto asset holding (as determined by the fair value of that holding): the name of the crypto asset, fair value, units held, and cost basis
2. At both annual and interim periods, the fair value and cost basis of other crypto asset holdings, which may be aggregated into a single line item
3. At annual periods, a reconciliation of activity between the beginning and end of the period for total crypto asset holdings. This disclosure would require that an entity disaggregate information by additions, dispositions, gains, and losses during the period and include a description of the additions and dispositions

FASB Project – Accounting for and Disclosure of Crypto Assets

FASB Board Meeting (cont'd)

The Board also decided to require an entity to disclose the following (cont'd):

4. At annual periods, for disposition of crypto assets during the period, the difference between the sale price and the cost basis of those assets
5. At both interim and annual periods, the fair value of the crypto assets that are restricted from sale, the nature and remaining duration of the restriction, and circumstances that could cause a lapse in the restriction(s)

FASB Staff Educational Paper – Intersection of Environmental, Social, and Governance Matters with Financial Accounting Standards

- Environmental
- Social
- Governance

FASB Staff Educational Paper – Intersection of Environmental, Social, and Governance Matters with Financial Accounting Standards

FASB Staff Educational Paper – March 21, 2021

- Subtopic 205-40, Presentation of Financial Statements-Going Concern-For example, compliance cost related to enacted emissions regulations that may impact the entity's going concern evaluation
- Topic 275, Risks and Uncertainties-Entity may determine that the effects of environmental matters (estimates) are material to the entity in the near term
- Topic 330, Inventory-Estimates of net realizable value could be materially affected by a regulatory change that renders inventories obsolete, or a significant weather event could cause physical damage to inventories, or a decrease in demand for an entity's goods resulting from changes in consumer behavior or an increase in completion costs because of disruptions in the supply chain

FASB Staff Educational Paper – Intersection of Environmental, Social, and Governance Matters with Financial Accounting Standards

FASB Staff Educational Paper – March 21, 2021 (cont'd)

- Topic 360, Property, Plant & Equipment-Environmental matters could give rise to impairment indicators. For example, A material decline in market demand for products or a change in regulation that adversely affects an entity could cause an asset impairment
- Topic 450, Contingencies-Loss contingencies could result from environmental or asset retirement obligations that may need to be accrued or recognized
- Topic 740, Income Taxes-ESG matters may affect future taxable income resulting in a recognized valuation allowance needed for deferred tax assets
- Topic 820, Fair Value Measurement-Fair value is used in accounting for business combinations, financial instruments, asset impairments, goodwill impairments, and lease classification. Based on the recognition of ESG matters by an organization, an asset's highest and best use may be affected causing an impact of the asset's fair value measurement

Unit 2

SEC Update

Learning Objectives

- Describe the SEC accounting and disclosure issues identified as priorities by the SEC
- Identify the recent statements by Paul Munter, Acting Chief Accountant of the SEC, concerning independent audits and auditor independence
- Identify the specific areas that the SEC staff have issued comment letters for companies filing 10-Ks and 10-Qs

SEC Topics

1. SAB 121, Accounting for Obligations to Safeguard Crypto-Assets
2. SEC Considerations for Special Purpose Acquisition Companies (SPACs)
3. SEC's Pay vs. Performance Disclosure Rules
4. SEC Proposals Related to Climate Change Disclosures
5. Auditor Independence
6. SEC Comment Letter Topics

SAB 121, Accounting for Obligations to Safeguard Crypto-Assets

Objective:

- SAB 121 adds interpretative guidance for reporting entities to consider when they have obligations to safeguard crypto-assets held for their platform users

SAB 121, Accounting for Obligations to Safeguard Crypto-Assets

Definitions:

- Crypto-Assets – Assets which can only and exclusively be transmitted by means of block-chain technology, including but not limited to digital coins and digital tokens and any other type of digital mediums of exchange

- Crypto-Currency Exchange - A cryptocurrency exchange (crypto exchange) is a platform that promotes the trade of cryptocurrencies using digital money, fiat money or other assets. These exchanges are the intermediaries between parties and make money from transaction fees and commissions

SAB 121, Accounting for Obligations to Safeguard Crypto-Assets

Provisions:

- SAB 121 requires a reporting entity within the scope of the SAB that operates a platform that allows its users (customers) to transact in crypto-assets and that also performs custodial activities, to record (recognize) a safeguarding liability with a corresponding asset, regardless of the reporting entities assessment as to who controls the crypto-asset

SAB 121, Accounting for Obligations to Safeguard Crypto-Assets

Provisions (cont'd):

- In addition, the SEC staff believes that it would be appropriate to measure this safeguarding liability at initial recognition and for each reporting period at its fair value based on Topic 820, Fair Value Measurement (measure) of the crypto-asset that the reporting entity is responsible for holding for its platform users
- The SEC staff also believe that the reporting entity should recognize an asset at the same time it recognizes the safeguarding liability, measured at initial recognition and for each reporting date at the fair value of the crypto-assets held for platform users

SEC Considerations for Special Purpose Acquisition Companies (SPACs)

A SPAC transaction can include the following steps:

1. SPAC formation
2. Raise capital through an IPO
3. Perform search for a target company to acquire
4. Negotiate with the target company
5. SEC S-1 Filing
6. Shareholder votes
7. 8K filing takes place
8. Acquisition (business combination) takes place

SEC Considerations for Special Purpose Acquisition Companies (SPACs)

- On January 11, 2022, the SEC warned that SPACs can't put disclaimers in their financial statements that their financial reporting could run afoul of the U.S. accounting rules
- Some SPACs have been issuing broad disclaimers that long-standing SPAC accounting practices could change and lead to future errors
- In other words, "accepted practice" may not the same as U.S. GAAP. Some companies are trying to limit their liability associated with the use of SPACs for acquisition purposes but the SEC believes this practice is inappropriate and may violate existing U.S. GAAP
- The SEC is saying "you are either following GAAP or you are not."

SEC Considerations for Special Purpose Acquisition Companies (SPACs)

- On March 30, 2022, the SEC issued a proposal titled Special Purpose Acquisition Companies, Shell Companies and Projections, including proposed rules intended to enhance investor protections in initial public offerings by special purpose acquisition companies ("SPACs") and in subsequent business combination transactions between SPACs and private operating companies
- Specifically, the SEC is proposing specialized disclosure requirements with respect to, among other things, compensation paid to sponsors, conflicts of interest, dilution, and the fairness of these business combination transactions

SEC's Pay vs. Performance Disclosure Rules

- The Securities and Exchange Commission adopted on August 25th 2022 amendments to its rules to require registrants to disclose information reflecting the relationship between executive compensation actually paid by a registrant and the registrant's financial performance
- The rules implement a requirement mandated by the Dodd-Frank Act in Section 953(a) of the Act. The amendments add new Item 402(v) of Regulation S-K
- The amendments require registrants to provide a table disclosing specified executive compensation and financial performance measures for their five most recently completed fiscal years
  - With respect to the measures of performance, a registrant will be required to report its total shareholder return (TSR), the TSR of companies in the registrant's peer group, its net income, and financial performance measures chosen by the registrant

SEC Proposals Related to Climate Change Disclosures

- The Securities and Exchange Commission in March of 2022 proposed rule changes that would require registrants to include certain climate-related disclosures in their registration statements and periodic reports, including information about climate-related risks that are reasonably likely to have a material impact on their business, results of operations, or financial condition, and certain climate-related financial statement metrics in a note to their audited financial statements
- The required information about climate-related risks also would include disclosure of a registrant's greenhouse gas emissions, which have become a commonly used metric to assess a registrant's exposure to such risks

SEC Proposals Related to Climate Change Disclosures

The proposed rule changes would require a registrant to disclose information about:

1. The registrant's governance of climate-related risks and relevant risk management processes
2. How any climate-related risks identified by the registrant have had or are likely to have a material impact on its business and consolidated financial statements, which may manifest over the short-, medium-, or long-term
3. How any identified climate-related risks have affected or are likely to affect the registrant's strategy, business model, and outlook
4. The impact of climate-related events (severe weather events and other natural conditions) and transition activities on the line items of a registrant's consolidated financial statements, as well as on the financial estimates and assumptions used in the financial statements

Auditor Independence

- The Importance of Auditor Independence
- The Auditor Independence Framework of Rule 2-01(b) of Regulation S-X
- Firm's Ethical Culture

SEC Comment Letter Topics

The most frequent comment letters in 2021 and 2022 by topic are as follows:

1. Non-GAAP financial measures
2. Management's discussion and analysis (MD&A)
3. Segment reporting
4. Risk Factors-climate change matters
5. Revenue recognition

SEC Comment Letter Topics

The most frequent comment letters in 2021 and 2022 by topic are as follows (cont'd):

6. Fair value measurement
7. Form compliance and exhibits
8. Disclosure controls and internal control over financial reporting
9. Inventory and cost of sales
10. Debt, quasi-debt, warrants, and equity

Unit 3

AICPA Update – Audit Engagements

Learning Objectives

- Describe the AICPA's recently issued quality management standards
- Identify and describe recently issued SASs (audit standards)
- Describe current audit issues and how these issues are being addressed

Peer Review Issues

The auditor's overall objectives when conducting risk-based audits of financial statements are to:

- Obtain reasonable assurance about whether the financial statements, as a whole, are free from material misstatement, whether due to error or fraud, thereby enabling the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework
- Report on the financial statements, or otherwise, as required by the SASs, in accordance with the auditor's findings, outlined in AU-C 315, Understanding the Entity and Its Environment and Assessing Risks of Material Misstatements, throughout the conduct of the audit

Peer Review Issues

Risk Assessment Process

1. Perform risk assessment procedures
2. Facilitate discussions among the audit engagement team
3. Develop an understanding of the audit client, its environment, and internal controls relevant to the audit
4. Identify the risk of material misstatement due to fraud or error at both the financial statement and relevant assertion levels
5. Identify the accounting processes that include assertion risks

Peer Review Issues

Risk Assessment Process (cont'd)

6. Identify the key controls within the accounting processes
7. Assess the risk of material misstatement identified as high, moderate, or low. Ensure that significant and fraud risks are identified.
8. Develop tailored audit procedures linked to the risks of material misstatement identified. Note that this is a critical step in the audit planning process, which is necessary to reduce these risks.
9. Document key aspects of the risk assessment process

Peer Review Issues

Deficiencies by Engagement Teams in the Risk-Based Audit Model

- Assessing and responding to risk
- Testing internal control over financial reporting
- Auditing estimates (AU-C 342 and AU-C 328)
- Audit sampling (completeness of the population and adequate sample sizes continue to be an issue)

Peer Review Issues

Four Most Common Risk Assessment Deficiencies (AICPA)

1. Internal Control – 40% of identified issues related to failure to gain an understanding of internal control when identifying the client's risks
2. No Linkage of Risks Identified to Procedures Performed – 24% of issues related to auditors not linking their risk assessments to their audit responses
3. Insufficient Risk Assessment – 14% of issues related to incomplete or non-existent risk assessment
4. Improper Control Risk – 13% of issues related to auditors assessing control risk as less than high without appropriately testing internal controls

Peer Review Issues

Five Most Common Risk Assessment Problems (State Societies)

1. Improper use of third-party practice aids – defaulting to a basic set of procedures without assessing risk and assessing risk at the financial statement level rather than at the financial assertion level
2. Defaulting to high control risk without adequately assessing and documenting the internal control or control risks
3. Reducing control risks to less than high without testing internal controls
4. Not identifying a significant risk in areas such as revenue recognition or other material non-routine transactions that require significant professional judgment
5. Not linking risk assessment and audit response and not tailoring programs to the unique risks identified at the client

Quality Management Standards – SQMS No. 1 and SQMS No. 2

- Increase firm leadership responsibilities and accountability, and improve firm governance
- Introduce a risk-based approach focused on achieving quality objectives
- Address technology, networks and the use of external service providers
- Increase focus on the continual flow of information and appropriate communication, internally and externally
- Promote monitoring of quality-management systems and timely and effective remediation of deficiencies

Quality Management Standards – SQMS No. 1 and SQMS No. 2

- Clarify and strengthen requirements for a more robust engagement quality review (EQR)
- Enhance the engagement partner's (EP's) responsibility for audit engagement leadership and audit quality

Quality Management Standards – SQMS No. 1 and SQMS No. 2

- Statement on Quality Management Standards (SQMS) 1, A Firm's System of Quality Management
- Statement on Quality Management Standards (SQMS) 2, Engagement Quality Reviews
- SAS 146, Quality Management for an Engagement Conducted in Accordance with Generally Accepted Auditing Standards
- SSARs 26, Quality Management for an Engagement Conducted in Accordance with Statements on Standards for Accounting and Review Services

Overview of the Suite of New audit Standards Issued in 2019/2020 Effective for Audits performed After December 15, 2021

- SAS 134, Auditor Reporting and Amendments, Including Amendments Addressing Disclosures in the Audit of Financial Statements
- SAS 135, Omnibus Statement on Auditing Standards-2019
- SAS 136, Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA
- SAS 137, Information in Documents Containing Audited Financial Statements
- SAS 138, Amendments to the Description of the Concept of Materiality

Overview of the Suite of New audit Standards Issued in 2019/2020 Effective for Audits performed After December 15, 2021

- SAS 139, Amendments to AU-C Sections 800, 805, and 810 to Incorporate Auditor Reporting Changes from SAS 134
- SAS 140, Amendments to AU-C Sections 725, 730, 930, 935, and 940 to Incorporate Auditor Reporting Changes from SASs 134 and 137
- SAS 141, Amendment to the Effective Dates of SAS Nos. 134 to 140

Updated Engagement Letters Based on the New Audit Standards

- The objective and scope of the audit of financial statements
- The responsibilities of the auditor
- The responsibilities of management
- A statement that 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

Updated Engagement Letters Based on the New Audit Standards

- Identification of the applicable financial reporting framework for the preparation of the financial statements
- Reference to the expected form and content of any reports to be issued by the auditor and a statement that circumstances may arise in which a report may differ from its expected form and content

Audit Update – 2023

SAS 142 – Audit Evidence

- SAS 142 addresses the evolving nature of business and audit services and issues that have arisen since AU-C Section 500, Audit Evidence, was originally issued
- The issues arising include the use of emerging technologies by both preparers and auditors, the application of professional skepticism, the expanding sources of information to be used as audit evidence, and more broadly, the accuracy, completeness, relevance, and reliability of audit evidence
- SAS 142 brings audit evidence into a more current perspective modernizing the guidance for today's and tomorrow's audits

Audit Update – 2023

SAS 142 – Audit Evidence (cont'd)

- The objective of the auditor is to evaluate information to be used as audit evidence including the results of audit procedures to inform the auditor's overall conclusion about whether sufficient appropriate audit evidence has been obtained

Audit Update – 2023

SAS 142 – Audit Evidence (cont'd)

Audit evidence is information used by the auditor in arriving at the conclusions on which the auditor's opinion is based

Audit evidence is information to which audit procedures have been applied and consists of information that corroborates or contradicts assertions in the financial statements

Audit evidence is the result of performing audit procedures as follows:

- Tests of controls
- Risk assessment procedures
- Substantive audit procedures

Audit Update – 2023

SAS 142 – Audit Evidence (cont'd)

- Sufficiency of audit evidence is the measure of the quantity of audit evidence. The quantity of audit evidence necessary is affected by the auditor's assessment of the risks of material misstatement and the quality of audit evidence obtained
- Appropriateness of audit evidence is the measure of the quality of audit evidence, that is, its relevance and reliability in providing support for the conclusions on which the auditor's opinion is based

Audit Update – 2023

SAS 142 – Audit Evidence (cont'd)

- SAS 142 is a documentation standard rather than a performance standard
- For example, SAS 142 expands the objective of prior guidance to be more broadly focused on considering the attributes of information to be used as audit evidence in assessing whether sufficient appropriate audit evidence has been obtained
- Prior audit evidence guidance focused on the design and performance of audit procedures to obtain sufficient appropriate audit evidence rather than evaluating the sufficiency and appropriateness of the audit evidence obtained

Audit Update – 2023

SAS 142 – Audit Evidence (cont'd)

This change is accomplished by establishing attributes of information to be used as audit evidence when evaluating whether sufficient and appropriate audit evidence has been obtained by the auditor

The reliability of information to be used as audit evidence is affected to varying degrees by the following attributes, individually or in combination:

- Accuracy
- Completeness
- Authenticity
- Susceptibility to bias

Audit Update – 2023

SAS 142 – Audit Evidence (cont'd)

When evaluating information to be used as audit evidence:

1. The auditor should evaluate information to be used as audit evidence by considering:
   - The relevance and reliability of the information, including its source, and
   - Whether such information corroborates or contradicts assertions in the financial statements

Audit Update – 2023

SAS 142 – Audit Evidence (cont'd)

When evaluating information to be used as audit evidence (cont'd):

2. The auditor's evaluation of the information to be used as audit evidence in accordance with the above should include:

   - Evaluating whether the information is sufficiently precise and detailed for the auditor's purposes, and
   - Obtaining audit evidence about the accuracy and completeness of the information, as necessary

Audit Update – 2023

SAS 142 – Audit Evidence (cont'd)

- Finally, SAS 142 states that an auditor may use automated tools and techniques to perform both a risk assessment procedure and a substantive procedure concurrently if the objectives of both types of procedures are achieved
- SAS 142 Exhibit

Audit Update – 2023

SAS 143, Auditing Accounting Estimates and Related Disclosures

Objective:

- SAS 143 is intended to enable auditors to appropriately address the increasingly complex scenarios that arise today from new accounting standards that include estimates and related disclosures, and to enhance the auditor's focus on factors driving estimation uncertainty and potential management bias
- In the current environment, management's estimates related to asset impairments are particularly important and SAS 143 will aid auditor's in assessing management's estimates during a period of economic uncertainty and volatility

Audit Update – 2023

SAS 143, Auditing Accounting Estimates and Related Disclosures (cont'd)

Objective (cont'd):

- The objective of the auditor is to obtain sufficient appropriate audit evidence about whether accounting estimates and related disclosures in the financial statements are reasonable, in the context of the applicable financial reporting framework
- SAS 143 supersedes AU-C Section 540, Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures

Audit Update – 2023

SAS 143, Auditing Accounting Estimates and Related Disclosures (cont'd)

Definitions:

- Accounting estimate - A monetary amount for which the measurement, in accordance with the requirements of the applicable financial reporting framework, is subject to estimation uncertainty
- Auditor's point estimate or auditor's range - An amount, or range of amounts, respectively, developed by the auditor in evaluating management's point estimate
- Estimation uncertainty - Susceptibility to an inherent lack of precision in measurement
- Management bias - A lack of neutrality by management in the preparation of information

Audit Update – 2023

SAS 143, Auditing Accounting Estimates and Related Disclosures (cont'd)

Provisions:

- SAS 143 requires the auditor to evaluate, based on the audit procedures performed and the audit evidence obtained, whether the accounting estimates and related disclosures are reasonable in the context of the applicable financial reporting framework or are misstated
- For the purposes of SAS 143, "reasonable", in the context of the applicable financial reporting framework, means that the relevant requirements of the applicable financial reporting framework have been applied appropriately

Audit Update – 2023

SAS 143, Auditing Accounting Estimates and Related Disclosures (cont'd)

Guidance:

- Explains the nature of accounting estimates and the concept of estimation uncertainty
- Provides information about scalability of the SAS for all types of accounting estimates, from those that are relatively simple to those that are complex
- Requires a separate assessment of inherent risk and control risk at the assertion level

Audit Update – 2023

SAS 143, Auditing Accounting Estimates and Related Disclosures (cont'd)

Guidance (cont'd):

- Includes an enhanced risk assessment model intended to address the challenges auditors face when auditing accounting estimates by providing risk assessment requirements that are more specific to estimates and addresses the increasingly complex business environment and complexity in financial reporting frameworks
- Emphasizes that the auditor's further audit procedures need to be responsive to the reasons for the assessed risks of material misstatement at the relevant assertion level

Audit Update – 2023

SAS 143, Auditing Accounting Estimates and Related Disclosures (cont'd)

Guidance (cont'd):

- Refers to relevant requirements in other AU-C sections and provides related guidance to emphasize the importance of the auditor's decisions about internal controls relating to accounting estimates
- Addresses the exercise of professional skepticism when auditing accounting estimates
- Requires the auditor to evaluate, based on the audit procedures performed and the audit evidence obtained, whether the accounting estimates and related disclosures are reasonable in the context of the applicable financial reporting framework

Audit Update – 2023

SAS 143, Auditing Accounting Estimates and Related Disclosures (cont'd)

Documentation:

- Key elements of the auditor's understanding of the entity and its environment, including the entity's internal control related to the entity's accounting estimates
- The linkage of the auditor's further audit procedures with the assessed risks of material misstatement at the relevant assertion level, considering the reasons given to the assessment of those risks
- The auditor's responses when management has not taken appropriate steps to understand and address estimation uncertainty

Audit Update – 2023

SAS 143, Auditing Accounting Estimates and Related Disclosures (cont'd)

Documentation (cont'd):

- Indicators of possible management bias related to accounting estimates, if any, and the auditor's evaluation of the implications for the audit, as required by paragraph
- Significant judgments relating to the auditor's determination of whether the accounting estimates and related disclosures are reasonable in the context of the applicable financial reporting framework or are misstated

Audit Update – 2023

SAS 144, Amendments to AU-C Sections 501, 540, and 620

Introduction:

SAS 144 makes changes to three existing audit standards:

- AU-C 501, Audit Evidence-Specific Considerations for Selected items
- AU-C 540, Auditing Accounting Estimates and Related Disclosures
- AU-C 620, Using the Work of an Auditor's Specialist

Audit Update – 2023

SAS 144, Amendments to AU-C Sections 501, 540, and 620

AU-C 501, Audit Evidence-Specific Considerations for Selected items:

- This section of AU-C 501 addresses specific consideration by the auditor, in obtaining sufficient appropriate audit evidence, regarding aspects of selected items, including use of management's specialist. The primary change in from SAS 144 is information related to the use of a management's specialist

Audit Update – 2023

SAS 144, Amendments to AU-C Sections 501, 540, and 620

AU-C 540, Auditing Accounting Estimates and Related Disclosures:

- SAS 144 adds a new appendix – Use of Pricing Information from Third Parties as Audit Evidence

- This appendix provides guidance on using pricing information as audit evidence for estimates related to fair value of financial instruments obtained from external information sources

Audit Update – 2023

SAS 144, Amendments to AU-C Sections 501, 540, and 620

AU-C 620, Using the Work of an Auditor's Specialist:

SAS 144 makes minor changes to AU-C 620 to enhance the guidance related to using work of an auditor's specialist. Two specific additions are as follows:

1. Agreement on the respective roles and responsibilities of the auditor and the auditor's specialist may include the degree of responsibility of the auditor's specialist

2. Examples of situations in which the auditor may conclude that the work of the auditor's specialist is not adequate for the auditor's purposes

Audit Update – 2023

SAS 145, Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement

Introduction:

- SAS 145 is an extensive audit standard over 200 pages in length - It is in response to peer review deficiencies identified in the risk assessment process performed by auditors
- SAS No. 145 enhances the requirements and guidance on identifying and assessing the risks of material misstatement, in particular the areas of understanding the entity's system of internal control and assessing control risk
    - The SAS also includes extensive guidance regarding the use of information technology (IT) and the consideration of IT general controls

Audit Update – 2023

SAS 145, Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement (cont'd)

Introduction (cont'd):

- The SAS revises the definition of significant risks, includes new guidance on maintaining professional skepticism, and includes a new "stand-back" requirement intended to drive an evaluation of the completeness of the identification of significant classes of transactions, account balances, and disclosures by the auditor

Audit Update – 2023

SAS 145, Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement (cont'd)

Introduction (cont'd):

The Auditing Standards Board's (ASB) project to enhance the auditing standards relating to the auditor's risk assessment through the issuance of SAS 145 is intended to enable auditors to appropriately address the following:

- Understanding the reporting entity's system of internal control, in particular, relating to the auditor's work effort to obtain the necessary understanding
- Modernizing the standard in relation to IT considerations, including addressing risks arising from a reporting entity's use of IT
- Determining risks of material misstatement, including significant risks

Audit Update – 2023

SAS 145, Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement (cont'd)

Objective:

- The objective of the auditor is to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels, thereby providing a basis for designing and implementing responses to the assessed risks of material misstatement

Audit Update – 2023

SAS 145, Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement (cont'd)

Risk-Based Auditing:

1. Risk assessment procedures
2. Discussions
3. Develop an understanding of the client, its environment, the applicable financial reporting framework, and internal controls
4. Identify the risk of material misstatement
5. Identify accounting processes
6. Identify key controls
7. Assess the risk of material misstatement
8. Develop tailored audit procedures
9. Document

Audit Update – 2023

SAS 145, Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement (cont'd)

SAS 145 Definitions:

- Assertions
- Business risk
- Controls
- General information technology (IT) controls
- Information processing controls
- Inherent risk factors
- IT environment

Audit Update – 2023

SAS 145, Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement (cont'd)

SAS 145 Definitions (cont'd):

- Relevant assertions
- Risks arising from the use of IT
- Risk assessment procedures
- Significant class of transactions, account balance, or disclosure
- Significant risk
- System of internal control

Audit Update – 2023

SAS 145, Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement (cont'd)

SAS 145 Definitions (cont'd):

Significant risk:

- *An identified risk of material misstatement for which the assessment of inherent risk is close to the upper end of the spectrum of inherent risk due to the degree to which inherent risk factors affect the combination of the likelihood of a misstatement occurring and the magnitude of the potential misstatement should that misstatement occur, or that is to be treated as a significant risk in accordance with the requirements of other AU-C sections*

Audit Update – 2023

SAS 145, Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement (cont'd)

Provisions:

Risks of material misstatement at the assertion level consists of two components: inherent risk and control risk:

- Inherent risk is described as the susceptibility of an assertion about a class of transactions, 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 is described as the risk that a misstatement that could occur in an assertion about a class of transactions, 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 reporting entity's system of internal control

Audit Update – 2023

SAS 145, Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement (cont'd)

Provisions (cont'd):

- Auditors are required based in SAS 145 to separately assess inherent and control risk

Audit Update – 2023

SAS 145, Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement (cont'd)

Provisions (cont'd):

SAS 145 stresses the need for the auditor to obtain an understanding of the:

- Reporting entity
- The entity's environment
- The applicable financial reporting framework
- The entity's system of internal control

Audit Update – 2023

SAS 145, Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement (cont'd)

Provisions (cont'd):

The auditor should perform risk assessment procedures to obtain an understanding of:

- The reporting entity's organizational structure, ownership and governance, and its business model, including the extent to which the business model integrates the use of IT
- Industry, regulatory, and other external factors
- The measures used, internally and externally, to assess the reporting entity's financial performance

Audit Update – 2023

SAS 145, Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement (cont'd)

Provisions (cont'd):

The auditor should perform risk assessment procedures to obtain an understanding of (cont'd):

- The applicable financial reporting framework and the reporting entity's accounting policies and the reasons for any changes
- How inherent risk factors affect the susceptibility of assertions to misstatement and the degree to which they do so, in the preparation of the financial statements in accordance with the applicable financial reporting framework, based on the understanding obtained
- The auditor should also evaluate whether the reporting entity's accounting policies are appropriate and consistent with the applicable financial reporting framework

Audit Update – 2023

SAS 145, Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement (cont'd)

Provisions (cont'd):

- System of internal control
- Control activities

Audit Update – 2023

SAS 145, Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement (cont'd)

Provisions – Documentation:

- The discussion among the engagement team and the significant decisions reached
- Key elements of the auditor's understanding with the sources of information from which the auditor's understanding was obtained; and the risk assessment procedures performed
- The evaluation of the design of identified controls, and determination whether such controls have been implemented
- The identified and assessed risks of material misstatement at the financial statement level and at the assertion level, including significant risks and risks for which substantive procedures alone cannot provide sufficient appropriate audit evidence, and the rationale for the significant judgments made

Audit Update – 2023

SAS 146, Quality Management for an Engagement Conducted in Accordance with Generally Accepted Auditing Standards

Objective:

The objective of the auditor is to manage quality at the engagement level to obtain reasonable assurance that quality has been achieved such that:

- The auditor has fulfilled the auditor's responsibilities, and has conducted the audit, in accordance with professional standards and applicable legal and regulatory requirements, and
- The auditor's report issued is appropriate in the circumstances

Audit Update – 2023

SAS 146, Quality Management for an Engagement Conducted in Accordance with Generally Accepted Auditing Standards (cont'd)

The engagement team, led by the engagement partner, is responsible, within the context of the firm's system of quality management and through complying with the requirements of SAS 146, for the following:

- Implementing the firm's responses to quality risks (that is, the firm's policies and procedures) that are applicable to the audit engagement using information communicated by, or obtained from, the firm
- Given the nature and circumstances of the audit engagement, determining whether to design and implement responses at the engagement level beyond those in the firm's policies and procedures

Audit Update – 2023

SAS 146, Quality Management for an Engagement Conducted in Accordance with Generally Accepted Auditing Standards (cont'd)

The engagement team, led by the engagement partner, is responsible, within the context of the firm's system of quality management and through complying with the requirements of SAS 146, for the following (cont'd):

- Communicating to the firm information from the audit engagement that is required by the firm's policies and procedures to be communicated to support the design, implementation, and operation of the firm's system of quality management

Audit Update – 2023

SAS 146, Quality Management for an Engagement Conducted in Accordance with Generally Accepted Auditing Standards (cont'd)

Documentation:

Significant issues identified, relevant discussions with personnel, and conclusions reached with respect to:

- Fulfillment of responsibilities relating to relevant ethical requirements, including those related to independence
- The acceptance and continuance of the client relationship and audit engagement

Audit Update – 2023

SAS 146, Quality Management for an Engagement Conducted in Accordance with Generally Accepted Auditing Standards (cont'd)

Documentation (cont'd):

- The nature and scope of, and conclusions resulting from, consultations undertaken during the audit engagement and how such conclusions were implemented
- If the audit engagement is subject to an engagement quality review, that the engagement quality review has been completed before the release of the auditor's report

Audit Update – 2023

SAS 147, Inquiries of the Predecessor Auditor Regarding Fraud and Noncompliance with Laws and Regulations

Objective:

- To require an auditor, once management authorizes the predecessor auditor to respond to inquiries from the auditor, to inquire of the predecessor auditor regarding identified or suspected fraud or noncompliance with laws or regulations
- SAS 147 amends SAS 122, Clarification and Recodification, as amended, section 210, Terms of Engagement

Audit Update – 2023

SAS 147, Inquiries of the Predecessor Auditor Regarding Fraud and Noncompliance with Laws and Regulations (cont'd)

Requirements:

- The auditor is required to inquire of the predecessor auditor regarding identified or suspected fraud and matters involving noncompliance with laws or regulations
- Predecessor auditor has a responsibility to respond on a timely basis. Predecessor is required to clearly state if the response is limited due to unusual circumstances
- When an engagement is accepted the auditor is required to document the inquiries and the results of these inquiries

Audit Update – 2023

SAS 148, Amendment to AU-C Section 935, Compliance Audits

Objective:

SAS 148 amends AU-C section 935 to update the appendix and conform AU-C section 935 to reflect the issuance of the following SASs:

- SAS 142, Audit Evidence
- SAS 145, Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement

Audit Update – 2023

SAS 148, Amendment to AU-C Section 935, Compliance Audits (cont'd)

- Compliance audit is defined in AU-C Section 935 as a program-specific audit of an organization-wide audit of an entity's compliance with applicable laws, regulations, rules, and provisions of contracts or grant agreements applicable to government programs with which the entity is required to comply

Audit Update – 2023

SAS 148, Amendment to AU-C Section 935, Compliance Audits (cont'd)

The auditor should perform risk assessment procedures, beyond inquiry, to evaluate whether the following controls that address risks of material non-compliance are effectively designed and determine whether those controls have been implemented:

- Controls over journal entries and other adjustments as required by section 240, Consideration of Fraud in a Financial Statement Audit

Audit Update – 2023

SAS 148, Amendment to AU-C Section 935, Compliance Audits (cont'd)

The auditor should perform risk assessment procedures, beyond inquiry, to evaluate whether the following controls that address risks of material non-compliance are effectively designed and determine whether those controls have been implemented (cont'd):

- Controls for which the auditor plans to test operating effectiveness in determining the nature, timing, and extent of substantive procedures, which include:
    1. Controls that address risks for which substantive procedures alone do not provide sufficient appropriate audit evidence, and
    2. Controls that are required to be tested for operating effectiveness by the governmental audit requirement

Audit Update – 2023

SAS 148, Amendment to AU-C Section 935, Compliance Audits (cont'd)

The auditor should perform risk assessment procedures, beyond inquiry, to evaluate whether the following controls that address risks of material non-compliance are effectively designed and determine whether those controls have been implemented (cont'd):

- Other controls that, based on the auditor's professional judgment, the auditor considers appropriate to enable the auditor to identify and assess risks of material noncompliance and design further audit procedures

AICPA Technical Questions and Answers (TQAs) in Auditing

- Reporting Guidance Upon Initial Implementation of SAS 134, As Amended
- Examining Journal Entries
- The Effect of Obtaining the Management Representation Letter on Dating the Auditor's Report
- Statutory Basis Financial Statements Differ from GAAP
- Restriction on Use of Report on Financial statements Prepared on a Basis of Accounting Prescribed in an Agreement

AICPA Technical Questions and Answers (TQAs) in Auditing

- Auditor Reporting When the Entity Issues Its Annual Report Subsequent to Its Financial Statements
- Condensed Financial Statements of a Non-Public Entity
- Going Concern Problem-Financial Statements Prepared on the Income Tax Basis of Accounting

Unit 4

AICPA Update – Attestation, Compilation and Review Issues

KAPLAN

Learning Objectives

- Identify and describe recently issued SSAEs (attestation standards)
- Apply SSARs requirements found in recently issued SSARs 25, Materiality in a Review of Financial Statements and Adverse Conclusions, to accounting and review service issues such as engagement terms, independence, reporting, and documentation
- Apply SSARS 26, Quality Management for an Engagement Conducted in Accordance with Statements on Standards for Accounting and Review Services, which enhances certain concepts related to quality management for engagements performed in accordance with SSARS

SSAE Updates

- Examination engagement
- Review engagement
- Agreed-upon procedures engagement

SSAE Updates

SSAE 20, Amendments to the Description of the Concept of Materiality

Objective:

- SSAE 20 aligns the materiality definition with the description of materiality used in the U.S. judicial system, the auditing standards of the PCAOB, the SEC, and the FASB
- The ASB believes it is in the public interest to eliminate inconsistencies between the AICPA Professional Standards and the description of materiality used by the U.S. judicial system and other U.S. standard setters and regulators

SSAE Updates

SSAE 20, Amendments to the Description of the Concept of Materiality (cont'd)

Materiality is defined in SSAE 20 as:

- Misstatements, including omissions, are considered to be material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements

SSAE Updates

SSAE 21, Direct Examination Engagements

Objective:

- SSAE 21 enables practitioners to perform an examination engagement in which the practitioner obtains reasonable assurance by measuring or evaluating underlying subject matter against criteria and expressing an opinion that conveys the results of that measurement or evaluation

SSAE Updates

SSAE 21, Direct Examination Engagements (cont'd)

Definitions:

- Assertion-based examination engagement
- Direct examination engagement
- Underlying subject matter
- Subject matter information
- Responsible party

SSAE Updates

SSAE 21, Direct Examination Engagements (cont'd)

SSAE 21 is organized in two sections:

- Section 205, Assertion-Based Examination Engagements
- Section 206, Direct Examination Engagements

- Report Examples

SSAE Updates

SSAE 22, Review Engagements

Objective:

- SSAE 22 describes the types of procedures a practitioner may perform in a review engagement - SSAE 22 also:
- Clarifies for practitioners that the objective of a review engagement is to obtain limited assurance
- Results in more transparent reporting by requiring that the practitioner disclose in a review report the procedures performed to obtain limited assurance
- Allows the practitioner to issue a report containing an adverse review conclusion when the subject matter is materially and pervasively misstated

SSAE Updates

SSAE 22, Review Engagements (cont'd)

While inquiry procedures are required, in addition to inquiry, SSAE No. 22 provides the following examples of procedures to obtain review evidence:

- Analytical procedures
- Inspection
- Observation
- Confirmation
- Recalculation
- Reperformance

SSAE Updates

SSAE 22, Review Engagements (cont'd)

- SSAE No. 22 includes a requirement that the practitioner's review report include a description of the work performed as a basis for the practitioner's conclusion
- SSAE No. 22 requires the practitioner to express an adverse conclusion when the practitioner, having obtained sufficient appropriate review evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the subject matter

SSAE Updates

SSAE 22, Review Engagements (cont'd)

To obtain limited assurance in a review engagement, the practitioner should do the following:

- Obtain an assertion from the responsible party
- Plan the work and properly supervise other members of the engagement team
- Focus procedures in areas where the practitioner believes increased risks of misstatements exist, whether due to error or fraud, based on the practitioner's understanding of the subject matter, its measurement or evaluation, the criteria, and other engagement circumstances

SSAE Updates

SSAE 22, Review Engagements (cont'd)

To obtain limited assurance in a review engagement, the practitioner should do the following (cont'd):

- Obtain review evidence, through the application of inquiry and analytical procedures or other appropriate procedures to obtain limited assurance that no material modifications should be made to the subject matter in order for it to be in accordance with) or based on) the criteria
- A review engagement would normally test fewer transactions or subject matter than that in an assertion-based or direct examination engagement
- Example Report

SSAE Updates

- AICPA Technical Questions and Answers (TQAS) in Attestation Engagements
- Testing Prospective Financial Information as Part of Performing Auditing Procedures
- Availability of Criteria for a Fee

SSARS Updates

SSARS 25, Materiality in a Review of Financial Statements and Adverse Conclusions

- SSARS 25 was issued February 2020, by the Accounting and Review Services Committee (ARSC)
- SSARS 25 aligns ARSC engagements closer to the International Standards for Review Engagements (ISRE 2400 – Engagements to Review Historical Financial Statements
- SSARS concepts, such as materiality, will also align with generally accepted auditing standards (GAAS)

SSARS Updates

SSARS 25, Materiality in a Review of Financial Statements and Adverse Conclusions (cont'd)

Definitions:

- Financial Reporting Framework
- Applicable Financial Reporting Framework
- Fair Presentation Framework
- Reasonable Period of Time
- Review Evidence
- Inquiry

SSARS Updates

SSARS 25, Materiality in a Review of Financial Statements and Adverse Conclusions (cont'd)

Definitions (cont'd):

- Limited Assurance
- Unmodified Conclusion
- Modified Conclusion
- Pervasive
- Qualified Conclusion
- Adverse Conclusion

SSARS Updates

SSARS 25, Materiality in a Review of Financial Statements and Adverse Conclusions (cont'd)

SSARS 25 Changes:

- General Principles – AR-C Section 60
- Preparation of Financial Statements – AR-C Section 70
- Compilation Engagements – AR-C Section 80
- Review of Financial Statements – AR-C Section 90

SSARS Updates

SSARS 25, Materiality in a Review of Financial Statements and Adverse Conclusions (cont'd)

Objectives of the Accountant:

- Obtain limited assurance, primarily by performing analytical procedures and inquiries, as a basis for reporting whether the accountant is aware of any material modifications that should be made to the financial statements for them to be in accordance with the applicable financial reporting framework
- Report on the financial statements as a whole and communicate, as required by AR-C 90

SSARS Updates

SSARS 25, Materiality in a Review of Financial Statements and Adverse Conclusions (cont'd)

Materiality in a Review of Financial Statements (cont'd):

In obtaining sufficient appropriate review evidence as the basis for a conclusion on the financial statements as a whole, the accountant should design and perform the analytical procedures and inquiries to address the following:

- All material items in the financial statements, including disclosures
- Areas in the financial statements where the accountant believes there are increased risks of material misstatements

SSARS Updates

SSARS 25, Materiality in a Review of Financial Statements and Adverse Conclusions (cont'd)

- Evaluating review evidence obtained from the procedures performed
- Consideration of the applicable financial reporting framework in relation to the financial statements
- Review documentation

SSARS Updates

SSARS 25, Materiality in a Review of Financial Statements and Adverse Conclusions (cont'd)

Review Documentation:

- The nature, timing, extent, and results of the work performed such as inquiry, analytical, or other procedures
- The review evidence obtained from the review procedures performed and the accountant's conclusion formed on the basis of that review evidence
- The source of the review evidence
- Significant matters arising during the review, the accountant's conclusions reached, and significant professional judgments made in reaching those conclusions

SSARS Updates

SSARS 25, Materiality in a Review of Financial Statements and Adverse Conclusions (cont'd)

Review Documentation (cont'd):

- An engagement letter
- A copy of the review report issued and the financial statements
- Analytical procedures performed
- Any additional review procedures performed in response to significant unexpected differences and the results of these procedures
- The results of significant inquiries

SSARS Updates

SSARS 25, Materiality in a Review of Financial Statements and Adverse Conclusions (cont'd)

Review Documentation (cont'd):

- Any significant findings or issues
- Significant unusual matters
- Any verbal or written communication of fraud or illegal acts
- Communications with management regarding the accountant's expectation to include emphasis-of-matter or other-matter paragraph(s) in the accountant's review report

SSARS Updates

SSARS 25, Materiality in a Review of Financial Statements and Adverse Conclusions (cont'd)

Review Documentation (cont'd):

- Communication with management and those charged with governance
- If, in the course of the engagement, the accountant identified information that is inconsistent with the accountant's findings regarding significant matters affecting the financial statements, how the inconsistency was addressed
- Communications with other accountants that have audited or reviewed the financial statements of significant components
- A signed representation letter

SSARS Updates

SSARS 25, Materiality in a Review of Financial Statements and Adverse Conclusions (cont'd)

- Report Examples

SSARS Updates

SSARS 26, Quality Management for an Engagement Conducted n Accordance with Statements on Standards for Accounting and Review Services

- As noted in Section 5, in June of 2022, the Auditing Standards Board (ASB) and the Accounting and Review Services Committee (ARSC) issued four interrelated standards on quality management (QM) designed to replace the existing Statement on Quality Control Standards
- SSARS 26 is one of these four standards
- SQMS 1 addresses the system of quality management, which forms the foundation for the management quality
- SSARS 26 primarily addresses how the engagement partner leverages the firm's system and manages quality at the engagement level

SSARS Updates

SSARS 26, Quality Management for an Engagement Conducted n Accordance with Statements on Standards for Accounting and Review Services (cont'd)

- SSARS 26 makes it clear that the engagement partner has overall responsibility for managing and achieving quality
- This includes creating an environment that emphasizes the firm's culture and expected behavior of engagement team members

SSARS Updates

SSARS 26, Quality Management for an Engagement Conducted n Accordance with Statements on Standards for Accounting and Review Services (cont'd)

This overall responsibility includes the following:

- Fulfilling leadership responsibilities – including taking actions to create an environment for the engagement that emphasizes the firm's culture and the expected behavior of engagement team members, and assigning procedures, tasks, or actions to other members of the engagement team
- Supporting engagement performance – including taking responsibility for the nature, timing, and extent of the direction, supervision, and review of the work performed

SSARS Updates

SSARS 26, Quality Management for an Engagement Conducted n Accordance with Statements on Standards for Accounting and Review Services (cont'd)

This overall responsibility includes the following (cont'd):

- Understanding of the relevant ethical and independence requirements – including whether other members of the engagement team are aware of those requirements and the firm's related policies and procedures
- Monitoring and remediation

SSARS Updates

AICPA Technical Questions and Answers (TQAS) in SSARS Engagements

- Issuing a Compilation Report on Financial Statements That Omit Substantially All Disclosures Required by an Applicable Financial Reporting Framework After Issuing a Report on Financial statements for the Same Period That Include Substantially All Disclosures Required by the Same Financial Reporting Framework
- Disclosure of Independence Impairment in the Accountant's Compilation Report on Comparative Financial Statements When the Accountant's Independence Is Impaired in Only One Period

Reminders

❑ **Post event evaluation:** Please complete the course evaluation that will be viewable once the session ends. We welcome your feedback!

KAPLAN