

A word cloud featuring various terms related to auditing and accounting. The most prominent word is 'Auditor' in large, bold, white letters. Other visible words include 'Misstatements', 'Reporting', 'Control', 'Error', 'Risk', 'Assurance', 'Federal', 'Non-profit', 'Value', 'Internal', 'Audited', 'helps', 'agencies', 'across', 'unrelated', 'consulting', 'express', 'conducting', 'act', 'object', 'pro', 'oper', 'add', 'app', 'effectiveness', 'accomplish', 'subject', 'manage', 'paid', 'internationally', 'authority', 'fraud', 'anies', 'terial', 'ed', 'systematic', 'improve', 'person', 'firm', 'publicly', 'controls', 'external', 'independent', 'regulatory', 'settle', 'industry', 'require', 'specific', 'design', 'govern', 'object', 'sett', 'indus', 'regulatory', 'exte'.

DEVELOPING AN AUDIT PROGRAM

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ABOUT THE SPEAKER

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- Mr. Einhorn is a partner with the New York CPA firm of S Einhorn and Company CPAs LLC.
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- Mr. Einhorn consults with numerous accounting firms, helping them prepare for peer review. He performs peer review for a number of firms as well.
- Is an alumnus of PriceWaterhouseCoopers LLP and Ernst & Young LLP.
- Featured A&A lecturer for ACE Seminars and is on the Peer Review Committee.
- Member of the NYSSCPA peer review report acceptance body.
- Contributing Author to the Real Estate Investment Trusts Handbook.

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AGENDA

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AGENDA

- AUDIT
 - AUDIT PLANNING
 - AUDIT PLANNING
 - SUBSTANTIVE AUDIT PROCEDURES
 - AUDIT PERFORMANCE

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AGENDA

- Risk Assessment and Response
- Planning Procedures
 - Engagement Acceptance
 - Engagement Independence Compliance
 - Financial Statement Materiality
 - Engagement Team Discussion
 - Fraud Risk Inquiries
 - Understanding Controls
 - Risk Assessment

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AGENDA

- Substantive Procedures
 - Cash
 - Accounts Receivable and Sales
 - Property
 - Other Assets
 - Accounts Payable
 - Accruals and Other Liabilities
 - Notes Payable and Long-Term Debt
 - Income Taxes
 - Equity
 - Income and Expense

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AGENDA

- Completion
 - Disclosure Checklist
 - Summary of Audit Differences
 - Supervision, Review, and Approval
 - Control Deficiency Evaluation

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AGENDA

- PEER REVIEW
 - KEY PEER REVIEW POINTS
 - ENHANCED AUDIT QUALITY INITIATIVE (AICPA)
 - CHANGES AT PICPA
 - WAYS TO PREPARE FOR A PEER REVIEW

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RISK ASSESSMENT AND RESPONSE

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Risk Assessment Is Fundamental

AUDIT

- Identifying Risk
- Assessing Risk
- Responding to Risk

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-
- Survey of peer reviewers, based on the 400 engagements they reviewed in 2014
 - Over half of firms failed to comply with AU-C 315 or 330
 - It isn't just whether the numbers are right, it's whether the auditor followed the standards

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Misconception driving non-compliance

- Auditors can perform a quality audit without properly considering their client's risk of material misstatement
- **Key Point:**
A quality audit gets the right answer the right way. Need to understand audit risk, then effectively and efficiently deploy resources to address that risk

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Audit risk model

RMM

Audit risk= Inherent Risk X Control Risk X Detection Risk

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What the audit is all about

- Identify RMM
- Assess RMM
- Respond to RMM

This is true regardless of amount and type of substantive testing performed!

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Identifying risk

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Misconceptions driving non-conformity

- Assumed client had no controls
- Did not believe any of the clients controls were relevant to the audit
- Thought responsibilities ended after determining controls relevant to the audit exist
- Believed many clients do not have significant risks

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Understanding your client

What's the point?

To assess and respond to RMM, an auditor should:

- Understand the nature of the client's inherent risks, which means the auditor should:
 - Understand the client and their environment

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Understanding the client's internal control

- Same logic applies
- To assess and respond to RMM, an auditor should:
 - Understand the nature of the client's control risks, which means the auditor should:
 - Understand the client's internal control

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What is internal control over financial reporting?

- Policies and procedures
- Designed and implemented by management
- Objective
 - **Prevent**, or
 - **Detect and correct** material misstatements in management's financial statements

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COSO Elements and Principles of Internal Controls

Elements of Internal Control	Principles
Control Environment	1. Demonstrates commitment to integrity and ethical values 2. Exercises oversight responsibility 3. Establishes structure, authority and responsibility 4. Demonstrates commitment to competence 5. Enforces accountability
Risk Assessment	6. Specifies suitable objectives 7. Identifies and analyzes risk 8. Assesses fraud risk 9. Identifies and analyzes significant change

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COSO Elements and Principles of Internal Controls

Element of Internal Control	Principles
Control Activities	10. Selects and develops control activities 11. Selects and develops general controls over tech 12. Deploys through policies and procedures
Information & Communication	13. Uses relevant information 14. Communicates internally 15. Communicates externally
Monitoring Activities	16. Conducts ongoing and/or separate evaluations 17. Evaluates and communicates deficiencies

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Why does COSO matter for small audit clients?

Considering the COSO Elements and Principles helps the auditor identify risks

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What if client has no controls ?

All entities have controls

- How could audit risk be reduced to an acceptably low level?

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Common controls at small entities

- Strong “tone at the top”
- Owner communicates importance of quality
- Accounts reconciled monthly
- Owner reviews financial results
- Log-in credentials
- Limits on check signing
- Physical access to cash, limited inventory
- Invoices marked “Paid” to avoid double payment
- Payroll reviewed by owner
- AP system doesn’t allow new vendor entry without authorization

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What do the standards require ? (AU-C 315.14)

- Obtain an understanding of controls relevant to the audit
 - What can go wrong?
 - Do controls exist to mitigate risks?
- Evaluate the design of the controls
- Determine whether they have been properly implemented
- This is a high bar!

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What if the auditor is not testing controls, and control risk is high?

Description	Understand level of control risk?	Understand nature of control risk?
Walkthrough	yes	yes
No walkthrough other assessment	yes	no

Should still assess design and implementation of controls to understand the nature of control risk

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Example: Impact of walkthrough

- Manufacturing client with material AR balance
- Control risk for AR valuation=high
- Client policy for allowance
 - 5% of balances fewer than 150 days old
 - 50% of balances 150 days or older
- Controller identifies uncollectible accounts throughout the year and writes off
- **What procedures would the auditor perform to test the allowance?**

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Example: Impact of walkthrough (continued)

- One approach: Subsequent receipts testing
 - Set dollar threshold; look at all receipts in scope
- Insights from walkthrough
 - Controller did not identify uncollectible receivables
 - No write-offs were recorded
- **How would the auditor's approach change because of the walkthrough?**

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Evaluating operating effectiveness of controls

- Different from evaluating design/implementation:
 - Evaluate whether the controls were **effective** in **meeting their objective** throughout the **reporting period**
- Is this a required procedure?
 - Only required if placing reliance to reduce substantive testing
- No operating effectiveness? No reliance!

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Identifying “significant risks”

- AU-C 315.04: Risks that require special audit consideration
- AU-C 315.28: Based on inherent risk only
- AU-C 315.A139: Often nonroutine transactions that require significant professional judgement
 - Complex calculations
 - Application of new/complex accounting principles
 - Nonroutine related party transactions

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Assessing Risk

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Misconceptions driving non-conformity

- Did not believe risk assessment was required at the relevant assertion level
- Thought documentation supporting risk assessment was only required if IR or CR assessed below the maximum
- Believed IR could be reduced based on competency of staff
- Thought control risk could be reduced below maximum based on design and implementation on controls
- Defaulted to high CR and IR to save time

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Objective of assessing risk

- Provide a basis for response
 - Nature
 - Timing
 - Extent
- Linked at the assertion (not account) level
- Assess risk at
 - Relevant assertion level
 - Financial statement level
(affecting many assertions)

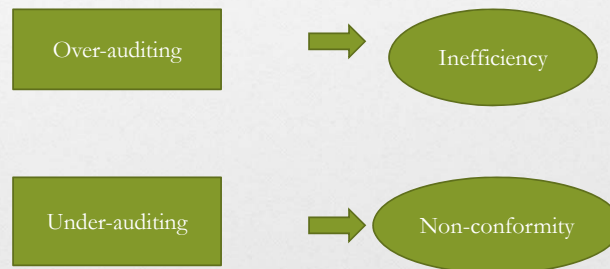
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Audit risk is not simple math

- Auditor should:
 - Consider fact and circumstances
 - Exercise professional judgement
 - NOT assume computed levels of RMM are always accurate
- Example: AP Cutoff

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Defaulting to high RMM without understanding the client



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Responding to risk

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Misconceptions driving non-conformity

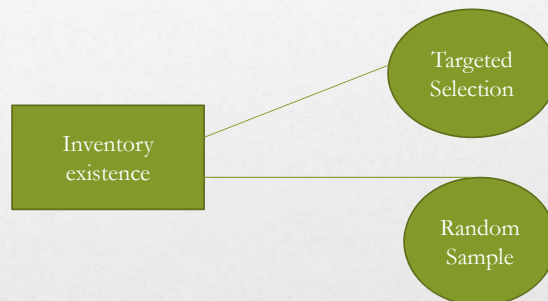
- Ignored the risk assessment after planning, believing that performing procedures in a standardized audit program would meet the requirements of the standards
- Believed performing the same procedures for all clients in a given industry was an appropriate audit approach
- Thought linkage between risks and audit responses could be “implied” and not documented
- Thought tailoring of audit programs to address significant risks was unnecessary in most cases
- No linkage between risk and planned responses

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No two audits are exactly the same

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Same industry different procedures



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Impact of control testing

- Determine whether controls are operating effectively
- If yes, can impact substantive procedures
 - Nature
 - Extent
 - Timing
- Can't rely on controls unless you've tested
- Evaluating design of controls does not equal control testing

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Improper use of third-party practice aids

- “Basic” approach does not mean auto-pilot
- “Extended” approach
 - Pick the right procedures to address the client’s specific risks
 - May need to tailor procedures or design your own
 - Especially true with significant risks

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Responding to significant risks

- Special audit consideration=beyond the norm
- Often requires
 - Modifying standardized procedures or
 - Adding additional procedures
- One or more arise on most audits

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AUDIT PLANNING

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THREE SECTIONS OF AUDIT PERFORMANCE

- AUDIT PLANNING
- SUBSTANTIVE AUDIT PROCEDURES
- AUDIT COMPLETION

IF IT WAS NOT DOCUMENTED IT WAS NOT DONE

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OVERARCHING PRINCIPLES

- IF IT WAS NOT DOCUMENTED IT WAS NOT DONE

STANDARD WE ARE HELD TO:

- SOMENONE NOT FAMILIER WITH THE ENGAGEMENT SHOULD BE ABLE TO
- UNDERSTAND THE WORK WE HAVE DONE
- FOLLOW THE WORK WE HAVE DONE
- REACH THE SAME CONCLUSION WE HAVE MADE

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AU-C Section 210

- The objective of the auditor is to accept an audit engagement for a new or existing audit client only
- Establishing whether the preconditions for an audit are present and
- Confirming that a common understanding of the terms of the audit engagement exists.

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AP-1: Audit Program for General Planning Procedures

- Prior to other significant audit activities, perform client acceptance or continuance procedures by completing or updating ASB CX1.1
- Establish and document an overall audit strategy that sets the scope, timing, and direction of the audit and the resources needed to perform the engagement.

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AP-1: Audit Program for General Planning Procedures (Cont.)

- Provide an engagement letter to the client and obtain an acknowledgment.
- If nonattest services are or will be performed for the client, complete to determine whether such services would create an independence threat.
- Communicate your responsibilities under GAAS and an overview of the planned scope and timing of the audit, including the nature and timing of expected communications, to those charged with governance.

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AP-1: Audit Program for General Planning Procedures (Cont.)

- Obtain and document an understanding of the entity and its environment, and identify risks by completing or updating . CX3.1
- Complete CX3.2 to document your engagement team discussion about the susceptibility of the entity's financial statements to material misstatements due to fraud or error and the application of GAAP to the entity's facts and circumstances.

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AP-1: Audit Program for General Planning Procedures (Cont.)

- Complete CX3.3 to document your inquiries of management and others about fraud and compliance with laws and regulations.
- Obtain and document an understanding of the entity's internal control system by completing or updating CX4.1 , (for each significant transaction class, financial close and reporting process, the IT environment, and general computer controls) CX4.2.1, CX4.2.2,CX4.3, and or (for each walkthrough performed).

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AP-1: Audit Program for General Planning Procedures (Cont.)

- Apply and document **preliminary analytical procedures** by (1) comparing account balances for the current period to similar amounts in the prior-period annual or interim financial statements or other expectations and (2) performing analytical procedures specifically related to revenue to identify potential fraudulent financial reporting. Identify unusual or unexpected balances or relationships and consider whether matters identified have financial statement and audit planning implications, such as whether they indicate a higher risk of material misstatement due to error or fraud.

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AP-1: Audit Program for General Planning Procedures (Cont.)

- Determine and document materiality levels by completing CX2.1.
- Assess the risk of material misstatement of the financial statements and develop your responses by completing CX7.1.
- Consider the need to apply one or more additional procedures.

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AP-1: Audit Program for General Planning Procedures (Cont.)

- We have performed procedures and obtained audit evidence sufficient to achieve the audit risk assessment and planning objectives. The procedures performed, evidence obtained, and our conclusions are adequately documented. (If you are unable to conclude on any objective, prepare a memo documenting your reason and the implications for the engagement, including the audit report.)

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CX-1.1: Engagement Acceptance and Continuance Form

- What services does the entity desire from our firm?
- Assist the client with the preparation of financial statement?
- Preparation of tax returns?

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CX-1.1: Engagement Acceptance and Continuance Form

- Has management refused, or are there indications that management will refuse or be unable, to do the following:
- Accept responsibility for the preparation and fair presentation of the financial statements or for the design, implementation, and maintenance of internal control over the financial statements?
- Be cognizant when responding to questions asked in the negative

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CX-1.1: Engagement Acceptance and Continuance Form

- We are satisfied that appropriate procedures regarding the acceptance and continuance of client relationships and specific audit engagements have been followed and conclusions reached are appropriate. We should accept/continue or not accept/continue the engagement.
- Mark accept assuming you want to accept the engagement.
- Sign off as engagement partner and date. If there is a concurring partner sign off as well or mark N/A if there is no concurring partner.
- Only complete if initial engagement Part II—Additional Acceptance Considerations for Initial Audit Engagements. If not initial engagement mark N/A.

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AUDIT STRATEGY MEMO

SAMPLE AUDIT PLANNING STRATEGY MEMORANDUM 12/31/16

The auditor assessed preliminary planning materiality at \$56,669.

As part of the audit discussion the engagement team detailed the strategy the team will follow to tests specific accounts as follows:

Cash

- Obtain bank reconciliation and verify accuracy and timely preparation of the bank reconciliation
- Trace deposits in transit and outstanding checks to the following months bank statement
- Verify bank accounts with financial institution
- Cash disbursement testing
- Scan general ledger for any unusual activity
- Overall analytical procedures

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ENGAGEMENT LETTER

- Updated for clarity standards
- We will audit the **financial statements** of , which **comprise** the balance sheet(s) as of , and the related statements of income, retained earnings, and cash flows for the then ended, and the related notes to the financial statements (the financial statements).
- Verify names of financial statement flow through on engagement letter, audit opinion, actual financial statements, and management representation letter.
- Engagement letter signed by both firm and the client.
- Date on engagement letter towards beginning of audit close to date of engagement acceptance.

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ASB-CX-1.2: Engagement Independence Compliance and Nonattest Services Documentation Form

- With respect to the engagement, have we obtained information from the firm (and network firms, where applicable) to identify and evaluate any circumstances and/or relationships that create threats to independence? (If threats to independence are identified, list the circumstances and/or relationships creating the threats in Part III.)

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ASB-CX-1.2: Engagement Independence Compliance

- Have we identified any breaches in our firm's independence policies and procedures that create a threat to independence for the engagement? (If "Yes," list the identified threats and the circumstances and/or relationships creating threats in Part III.)

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ASB-CX-1.2: Engagement Independence Compliance

Nonattest service to be provided	Engagement objectives	Firm responsibilities for the nonattest service	Limitations, if any, of the nonattest services to be provided

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ASB-CX-1.2: Engagement Independence Compliance

Nonattest service to be provided	Assume all management responsibilities?	Oversee services by designating an individual with suitable SKE? (Indicate name and title.)	Evaluate the adequacy and results of the service?	Accept responsibility for the results of the service?	Assessment of the SKE and understanding of the designated individual

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ASB-CX-1.2: Engagement Independence Compliance

- Before accepting a nonattest service, if multiple nonattest services will be performed, have we evaluated whether the performance of multiple services will create, in the aggregate, a significant threat that will not be reduced to an acceptable level through the safeguards in item 2? [If significant threats are identified as a result of the evaluation, document the threat(s) in Part III.]

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ASB-CX-1.2: Engagement Independence Compliance

Circumstances contributing to the identified threat	Nature of the threat	Specific (or additional) safeguards that were applied	Was the threat eliminated or reduced to acceptable level? (Y/N)

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ASB-CX-1.2: Engagement Independence Compliance

- Considering independence requirements applicable to the engagement and any identified threats to independence, along with applicable safeguards applied, conclude whether we are independent on the engagement:
- Yes; we are independent with respect to the engagement.
- Sign off as engagement partner and sign off as engagement quality control reviewer. If no engagement quality control reviewer mark N/A

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Communication with Those Charged with Governance during Planning

- *AU-C 260, The Auditor's Communication With Those Charged With Governance* , applies to all nonpublic entities regardless of the entity's governance structure or size and establishes requirements for communicating with those charged with governance.
- Authors believe the engagement letter may be used to make the communications during planning and this letter would not be needed.

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ASB-CX-3.1: Understanding the Entity and Identifying Risks

- List any known related parties and all known transactions with related parties (such as subsidiaries, affiliates, partnerships, joint ventures, relatives, etc.).
- Describe potential financial statement risks related to the entity's structure, ownership, governance, and related-party relationships and transactions. Consider risks that could result in misstatements of the financial statements.

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ASB-CX-3.1: Understanding the Entity and Identifying Risks

- Can overcome improper revenue recognition, however easier to document than to overcome.
- If Firm identifies additional risks they must be specifically responded to in audit program.
- Tip do not identify additional risks.
- Minimum requirement management override of controls and improper revenue recognition.

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ASB-CX-3.1: Understanding the Entity and Identifying Risks

- Describe the entity's benefit plans, including vacation and sick pay policies and any employee pension, postemployment, postretirement, stock compensation, or profit sharing plans. (Obtain a copy of the plans or prepare excerpts for retention in the client's permanent file. Review new documents or changes in documents for matters affecting the entity's accounting, the financial statements, or the audit.)
- The heart of the question is do we need to accrue for compensated absences.

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ASB-CX-3.1: Understanding the Entity and Identifying Risks

- Three options for vacation policy
- Accrue vacation
- Use it or lose it-no accrual necessary.
- Disclose no compensated absences accrual because not practical and not reasonably estimable.

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ASB-CX-3.1: Understanding the Entity and Identifying Risks

- What AICPA guides, AICPA Industry Audit Risk Alerts, industry publications, etc., provide information on the entity's industry that is relevant for the audit?
- Identify any new guidance and its effect on the audit.

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ASB-CX-3.1: Understanding the Entity and Identifying Risks

- Consider whether information gathered about the entity and its environment, including the consideration of fraud risk factors, indicates potential risks that could result in misstatements of the financial statements due to fraud, and describe those potential risks. Describe which types of revenue, revenue transactions, or assertions give rise to the risk of improper revenue recognition due to fraud.

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ASB-CX-3.1: Understanding the Entity and Identifying Risks

- Describe the sources of information used and procedures performed to obtain or update your understanding of the entity and its environment.
- Be specific- who we interviewed and specific date.
- Document audit year sign off and date

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ASB-CX-3.2: Engagement Team Discussion

- Discussion Date
- Discussion Participants
- All required discussions must be addressed and responded to

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ASB-CX-3.2: Engagement Team Discussion

Required Discussion Topics

- Critical issues and areas of significant audit risk.-
- Areas susceptible to management override of controls.-

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ASB-CX-3.2: Engagement Team Discussion

Required Discussion Topics

- Unusual accounting practices used by the client.-
- Application of GAAP to the entity's facts and circumstances in light of its accounting policies. –
- Important control systems.-

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ASB-CX-3.2: Engagement Team Discussion

Required Discussion Topics

- Significant IT applications and how the use of IT may affect the audit. -
- Materiality levels and how materiality will be used to determine the extent of testing.-

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ASB-CX-3.2: Engagement Team Discussion

Required Discussion Topics

- The need to exercise professional skepticism throughout the engagement, be alert for information or other conditions that indicate that a material misstatement due to fraud or error may have occurred, and to be rigorous in following up on such indications.

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ASB-CX-3.2: Engagement Team Discussion

Required Discussion Topics

- How and where the entity's financial statements (for example, which accounts or transaction classes) might be susceptible to material misstatement due to fraud. -

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ASB-CX-3.2: Engagement Team Discussion

Required Discussion Topics

- Circumstances that might indicate earnings management or manipulation of other financial measures.-

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ASB-CX-3.2: Engagement Team Discussion

Required Discussion Topics

- Practices that management might use to manage earnings or other financial measures that could lead to fraudulent financial reporting. The engagement team did not note any practices which management might use to manage earnings or other financial measures that could lead to fraudulent financial reporting.

How the entity's assets could be stolen. -

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ASB-CX-3.2: Engagement Team Discussion

Required Discussion Topics

- External and internal factors that might create incentives/pressures, provide opportunities, or enable rationalization of fraud.-

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ASB-CX-3.2: Engagement Team Discussion

Required Discussion Topics

- How the engagement team might respond to the susceptibility of the client's financial statements to material misstatement due to fraud. The engagement team will inquire of both management and regular personnel if they are aware of fraud. -

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ASB-CX-3.2: Engagement Team Discussion

Required Discussion Topics

- Known related party relationships and transactions, the possibility of unidentified related parties and how those might be identified, and the susceptibility of the financial statements to material misstatement due to fraud or error that could result from related party relationships and transactions, including how related parties could be used to perpetrate fraud.

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ASB-CX-3.2: Engagement Team Discussion

- Significant Decisions/Planned Responses:

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ASB-CX-3.3: Fraud Risk Inquiries Form

- Inquire of management personnel or the owner/manager about the risks of fraud and how the entity addresses them and about compliance with laws and regulations. Specifically ask about the following:
 - Their knowledge of any actual fraud or suspicions of fraud affecting the entity.
 - Their awareness of any allegations of fraud or suspected fraud affecting the entity.

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ASB-CX-3.3: Fraud Risk Inquiries Form

- Management Personnel Interviewed
- Include the following:
 - Name
 - Title
 - Date
- Ideally three management level personnel

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ASB-CX-3.3: Fraud Risk Inquiries Form

- Document the responses, including any information that may be relevant to identifying fraud risks.

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ASB-CX-3.3: Fraud Risk Inquiries Form

- Inquire of employees about whether they are aware of fraud that is occurring or is alleged, or have suspicions of fraudulent activity. For employees involved in the financial reporting process, also inquire about unusual or improper journal entry or other adjustment activity.

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ASB-CX-3.3: Fraud Risk Inquiries Form

- Employees Interviewed
- Include the following:
 - Name
 - Title
 - Date
- Ideally three employee level personnel

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ASB-CX-3.3: Fraud Risk Inquiries Form

- Document the responses, including any information that may be relevant to identifying fraud risks.

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INTERNAL CONTROLS

- AS PART OF AN AUDIT WE ARE **REQUIRED TO UNDERSTAND CONTROLS.**
- NO REQUIREMENT TO TEST CONTROLS UNLESS RELYING ON CONTROLS.
- ONLY WORK WITH ONE FIRM ONE CLIENT WHERE RELY AND TEST CONTROLS FOR ONLY ACCOUNTS RECEIVABLE

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INTERNAL CONTROLS

- WE REFER TO TWO TYPES OF CONTROLS
- **ENTITY LEVEL CONTROLS-** HIGH LEVEL CONTROLS AT THE COMPANY OR ORGANIZATION AS A WHOLE
- **PROCESS LEVEL CONTROLS-** CONTROLS AROUND THE PROCESSES OF THE COMPANY OR THE ORGANIZATION

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ENTITY LEVEL CONTROLS

- **Control Environment**
- **Risk Assessment**
- **Information and Communication**
- **Monitoring**

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ENTITY LEVEL CONTROLS

- **Control Environment**

- How the attitudes, awareness, and actions of management, as well as those charged with governance, demonstrate its commitment to accurate accounting and financial reporting.
- Evaluate whether management has created and maintained a culture of honesty and ethical behavior, the control environment provides an appropriate foundation for the other components of internal control, and those other components are not undermined by deficiencies in the control environment

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ENTITY LEVEL CONTROLS

- **Control Environment**

- The entity demonstrates a commitment to integrity and ethical values.
- The board of directors demonstrates independence from management in exercising oversight of the development and performance of internal control over financial reporting.
- With board oversight, management establishes structures, reporting lines, and appropriate authorities and responsibilities to achieve financial reporting objectives.
- The entity demonstrates a commitment to attract, develop, and retain competent individuals in alignment with financial reporting objectives.
- The entity holds individuals accountable for their internal control responsibilities.

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ENTITY LEVEL CONTROLS

- **Risk Assessment**

- What management does to identify and respond to business or operations risks that may affect accounting or financial reporting.
- Risk assessment involves management identifying potential risks of misstatement in the financial statements, estimating their significance, assessing the likelihood of their occurrence, and implementing control activities or taking other steps to address those risks.

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ENTITY LEVEL CONTROLS

- **Risk Assessment**

- The entity specifies objectives with sufficient clarity to enable the identification and assessment of risks relating to financial reporting objectives.
- The entity identifies risks to achieving its objectives and analyzes risks to determine how the risks should be managed.
- The entity considers the potential for fraud in assessing risks to the achievement of financial reporting objectives.
- The entity identifies and assesses changes that could significantly impact the system of internal control.

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ENTITY LEVEL CONTROLS

- **Information and Communication**

- The overall availability and timeliness of information (both internal and external) necessary for internal controls and the financial reporting system to function properly.
- This involves determining how the right information is made available to the right people at the right time. Also, describe how management communicates financial reporting roles and responsibilities and significant financial reporting matters to employees, those charged with governance, and appropriate external parties (such as regulatory authorities) and how exceptions are brought to the attention of persons at the appropriate level to take corrective action.

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ENTITY LEVEL CONTROLS

- **Information and Communication**

- The entity obtains or generates and uses relevant, quality information to support the functioning of internal control over financial reporting.
- The entity internally communicates information, including objectives and responsibilities for internal control, necessary to support the functioning of internal control over financial reporting.
- The entity communicates with external parties regarding matters affecting the functioning of internal control.

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ENTITY LEVEL CONTROLS

- **Monitoring**
- Describe how management monitors the operation of the entity's five components of internal control to make sure
- (a) controls are operating as intended and
- (b) changes to controls are made when necessary. Also describe what reports or other information (such as budget variances, reconciliations, or monthly financial reports) management uses for that purpose and why management considers the information reliable. Consider controls relevant to the audit.

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ENTITY LEVEL CONTROLS

- **Monitoring**
- The entity selects, develops, and performs ongoing and/or separate evaluations to determine whether the components of internal control are present and functioning.
- The entity evaluates and communicates internal control deficiencies in a timely manner to those parties responsible for taking corrective action, including senior management and the board of directors, as appropriate.

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PROCESS LEVEL CONTROLS

ASB CX4.2.1 and ASB CX4.3

- Required to **understand** controls
- Test controls only if relying on controls
- 2 Steps to document our **understanding** of controls:
 - **Narrative**
 - **Walkthrough**

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PROCESS LEVEL CONTROLS

- **Narrative-** The story which takes place behind a transaction.
- **Walkthrough-** The paper flow of one transaction to support the story which was described in the narrative.
- Can either document
- Using ASB CX4.3 but must be specific as to what transaction and documents we actually reviewed.
- Or request actual documents and tie out and put in audit file to support the story in the narrative

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PROCESS LEVEL CONTROLS

- At a minimum must include narrative and walkthrough of the following processes:
- **Cash Receipts-** Must include cash, accounts receivable, and revenue.
- **Cash Disbursements-** Must include cash, accounts payable, and expenses.
- **Payroll-** Must include payroll accrual and expense. If using service organization must be included in narrative and walkthrough.

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IT ENVIRONMENT AND GENERAL COMPUTER CONTROLS ASB CX4.2.2

Applica tion	Transac tion Classes	Service Organi zation Name (if applica ble)	Interna lly Develo ped?	Vendor /Brand Name and Version	Custom Feature s (if any)	Does Client Have Access to Source Code?
General Ledger	All	N/A	No	Quickbo oks	Can customi ze	No
Payroll	Payroll	ADP	N/A	N/A	N/A	N/A

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IT ENVIRONMENT AND GENERAL COMPUTER CONTROLS ASB CX4.2.2

- If a service organization is used (e.g., for payroll financial system hosting, etc.), describe how the service organization is used, along with your conclusion about whether it is necessary to obtain an understanding of controls at the service organization
- Identify significant entity-developed spreadsheets that are used for accounting functions or transaction processing.
- Document whether those spreadsheets are password protected and if there are logical controls built into the spreadsheets to protect their integrity (e.g., are input fields a different color so data is not entered into the wrong cells, and are cells with formulas locked so they cannot be changed without approval?)

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IT ENVIRONMENT AND GENERAL COMPUTER CONTROLS ASB CX4.2.2

- Describe any other information relevant to understanding the entity's IT environment (for example, the computer hardware and configuration used for the accounting system such as networked personal computers with a dedicated server, any significant master files that are used to store data relevant to the audit, or the entity's use of e-commerce or other sophisticated processing applications).

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IT ENVIRONMENT AND GENERAL COMPUTER CONTROLS ASB CX4.2.2

- Is the **use** of an **IT specialist** considered **necessary**?
- Generally for company size we work on response is no.
- In the event we do need IT specialist
- The Other General Planning Procedures at ASB AP-1 provides program steps when using specialists.

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IT ENVIRONMENT AND GENERAL COMPUTER CONTROLS ASB CX4.2.2

- Obtain an understanding of how the entity has responded to risks arising from IT.
- Describe how the entity ensures that its IT systems (including any significant entity-developed spreadsheets) are reliable and its data is secure.
- Consider the controls over the
 - development,
 - modification,
 - and testing of new or significant applications or spreadsheets as well as physical security and backup procedures

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IT ENVIRONMENT AND GENERAL COMPUTER CONTROLS ASB CX4.2.2

- Consider
- The entity has an IT strategic planning and risk management process in place to support its financial reporting requirements.
- The entity maintains reliable systems that include appropriate data backup and recovery processes.
- Physical security and access to programs and data are appropriately controlled to prevent unauthorized use, disclosure, modification, damage, or loss of data.
- Program changes (including report development) and systems acquisition and development are appropriately managed to ensure that the application software and reports adequately support internal control and financial reporting objectives.

111

IT ENVIRONMENT AND GENERAL COMPUTER CONTROLS ASB CX4.2.2

- Describe the sources of information used and procedures performed to obtain or update your understanding of the entity's general computer controls and to evaluate the design of those controls and determine whether they have been implemented.
- Considering the size and complexity of the entity, are general computer controls properly designed and implemented to achieve the significant control objectives.
- Document for what year was form completed sign off and date.

112

Financial Statement Materiality CX2.1

- Basis for Materiality Amounts
 - Considering the needs and expectations of financial statement users, describe the rationale for the selection of the benchmark and percentages

113

Financial Statement Materiality CX2.1

- Changes in Planning Materiality Amounts

Document any changes in planning materiality or performance materiality/tolerable misstatement levels that occur during the audit and how they were determined.

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RISK ASSESSMENT SUMMARY ASB CX7.1

- Significant Audit Area
- Audit Area
- Identified Risks/Assertions Affected
- Indicate If Significant Risk
- Risk Assessment Documentation Approach
- Inherent Risk
- Control Risk
- Assessed Risk of Material Misstatement
- Audit Approach

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RISK ASSESSMENT SUMMARY ASB CX7.1

Significant Audit Area

- An audit area includes
- The related account balances, transaction classes, and disclosures.
- An audit area generally is significant if it contains a:
 - significant transaction class,
 - material account balance,
 - fraud risk or other significant risk,
 - or requires significant disclosures.

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RISK ASSESSMENT SUMMARY

ASB CX7.1

Audit Areas

- Cash
- Accounts Receivable/Sales
- Inventory/Cost of Sales (including Inventory Observation)
- Property
- Investments and Derivatives
- Other Assets
- Accounts Payable and Other Liabilities
- Notes Payable/Long-term Debt
- Income Taxes
- Equity
- Income and Expense

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RISK ASSESSMENT SUMMARY

ASB CX7.1

Identified Risks/Assertions Affected

- Based on your understanding of the entity obtained when performing risk assessment procedures and the conclusions reached, list
- (1) any specifically identified risk that is of a magnitude that could result in material misstatement of the financial statements and
- (2) the related assertions

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RISK ASSESSMENT SUMMARY

ASB CX7.1

Identified Risks/Assertions Affected

- There is a presumption that you will identify **improper revenue recognition** due to fraud as a risk of material misstatement.

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RISK ASSESSMENT SUMMARY

ASB CX7.1

Indicate If Significant Risk

- Indicate if the identified risk of material misstatement is a fraud risk or other significant risk by placing an "F" if the risk is a fraud risk or an "S" in if the risk is a significant risk other than a fraud risk.
If the risk is not a fraud risk or other significant risk, leave blank.
- When considering whether an identified risk is a significant risk, determine if it relates to
 - (1) significant economic, accounting, or other developments needing specific attention;
 - (2) complex transactions;
 - (3) significant related-party transactions;
 - (4) measurements that are subjective or uncertain, especially estimates with a high degree of uncertainty; or
 - (5) significant transactions outside the normal course of business or that otherwise appear unusual. Treat significant related-party transactions outside the normal course of business as significant risks.

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RISK ASSESSMENT SUMMARY

ASB CX7.1

Risk Assessment Documentation Approach

- Assess the risk of material misstatement at the relevant **assertion level**.
- For audit areas that are not significant, or for significant areas where you have not identified any specific risks, it may be appropriate and more efficient to document the risk assessment for the audit area as a whole.

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RISK ASSESSMENT SUMMARY

ASB CX7.1

Assertions

- Existence or Occurrence (E/O)
- Completeness (C)
- Rights or Obligations (R/O)
- Accuracy or Classification (A/CL)
- Valuation or Allocation (V)
- Cutoff (CO)

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RISK ASSESSMENT SUMMARY

ASB CX7.1

Inherent Risk

- Assuming there are no controls in place.
- What is the risk as it relates to a specific account, specific assertion that something can go wrong?
- Example: As it relates to cash what is the risk that a transaction did not exist or occur.

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RISK ASSESSMENT SUMMARY

ASB CX7.1

- Control Risk
- Assuming there are controls in place
- What is the risk the control will not catch the what could go wrong identified?
- **If no testing of controls is documented control risk must be High.**

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RISK ASSESSMENT SUMMARY

ASB CX7.1

Combined risk of material misstatement

- $\text{Inherent Risk} \times \text{Control Risk} = \text{Combined Risk}$

<u>Inherent Risk</u>	<u>×</u>	<u>Control Risk</u>	<u>=</u>	<u>Risk of Material Misstatement</u>
High		High		High
High		Moderate		High
High		Low		Moderate
Moderate		High		Moderate
Low		High		Low

RISK ASSESSMENT SUMMARY

ASB CX7.1

Cash

Assertion	Inherent Risk	Control Risk	Assessed Risk of Material Mistatement	Audit Approach
E/O	L	H	L	B
C	L	H	L	B
R/O	L	H	L	B
V	NR	NR	NR	NR
A/CL	L	H	L	B
CO	M	H	M	B

INHERENT RISK ASSESSMENT
FORM ASB CX7.2
Cash

Assertion	Engagement Risk	Accounting Issues	Auditing Issues	Prior Period Misstatements
E/O	L	M	L	L
C	L	L	L	L
R/O	L	L	L	L
V	NR	NR	NR	NR
A/CL	L	L	L	L
CO	M	H	M	M

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INHERENT RISK ASSESSMENT
FORM ASB CX7.2
Cash

Susceptibility to Fraud	Need for Judgment	Nature of Items	Complexity	Comments
E/O	L	L	L	L
C	L	L	L	L
R/O	L	L	L	L
V	NR	NR	NR	NR
A/CL	L	L	L	L
CO	M	M	M	M

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GENERAL AUDITING AND COMPLETION PROCEDURES

129

JOURNAL ENTRY TESTING

- Select and test journal entries, including all material adjustments made by the client in preparing the financial statements, by performing the following procedures:
- Scan the general ledger and select specific journal entries for testing. Document the items selected.
- Examine the related accounting records and supporting documents to determine whether the selected entry is valid and appropriate. Obtain an understanding of the underlying transaction and determine that the entry was properly recorded in the general ledger in the correct accounting period.
- Identify and consider the appropriateness of material journal entries and significant adjustments to general ledger balances (such as post-closing entries, consolidating adjustments, report combinations, and reclassifications) made in the preparation of financial statements. Examine supporting documentation or agree amounts to the audit workpapers where tested.

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JOURNAL ENTRY TESTING

Date	Description	\$ Amount	Support Attached	Signed off by preparer	Signed off by reviewer
6/26/17	To record depreciation	43,723	X	X	X

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COMMITMENTS AND CONTINGENCIES

- Perform a search for previously unidentified commitments and contingencies by performing the following procedures:
- Review the results of audit procedures applied to specific accounts or other general procedures for the existence of significant commitments or contingencies.
- Update your inquiries of management and others about the possibility of unrecorded contingencies or commitments.
- Obtain from management a description and evaluation of any pending litigation, claims, or assessments and review legal correspondence, legal expense accounts, invoices from external legal counsel, and other supporting documents.
- Obtain a legal representation letter from the client's outside and/or inside legal counsel and evaluate the responses.

132

COMMITMENTS AND CONTINGENCIES

Legal Representation

- Legal Letter

If company does not engage internal or external legal counsel.

- Two step process and include in management representation letter.

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COMMITMENTS AND CONTINGENCIES

- Step 1:

Inquired of management as to whether there is any litigation, claims or assessments. Management responded they are not aware of any litigation, claims or assessments.

- Step 2:

The auditor did not identify any actual or potential litigation, claims or assessments.

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COMMITMENTS AND CONTINGENCIES

- Conclusion:

The auditor concludes that no direct communication is required with the entity's external legal counsel in connection with actual or potential litigation, claims, or assessments that may give rise to a risk of material misstatement, since no potential litigation, claims, or assessments were identified.

- Include in management representation letter.
- Management of the Company is not aware of any actual, threatened, or potential litigation and did not engage internal or external legal counsel.

135

SIGNIFICANT ESTIMATES OR CONCENTRATIONS

Perform the following procedures to assess whether significant estimates and concentrations have been identified and properly presented or disclosed:

- Review the results of audit procedures applied to specific accounts or other general procedures for the existence of significant estimates and concentrations.
- Update your inquiries of management about circumstances that require new, or the need to revise existing, accounting estimates and about the existence of concentrations.
- Consider whether there have been, or ought to have been, changes in the methods or underlying assumptions used to develop accounting estimates.
- Evaluate whether management's judgments and decisions in making accounting estimates, even if they are individually reasonable, indicate a possible bias on the part of management that may represent a risk of material misstatement due to fraud.

136

SUBSEQUENT EVENTS

Perform the following review for subsequent events to the date of the auditor's report:

- Inquire of management about (1) the procedures that management has established to identify subsequent events and (2) the existence of material subsequent events. Inquire about the status of items unresolved at the balance-sheet date.
- Review the accounting records subsequent to year end to the date of the auditor's report for evidence of significant transactions related to the financial statements under audit.

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SUBSEQUENT EVENTS

- Read the minutes for meetings held subsequent to the date of the initial reading of minutes and inquire about matters discussed at meetings for which minutes are not yet available.
- Determine whether events occurring up to the date of the auditor's report provide audit evidence about accounting estimates.
- Read any financial statements or significant financial reports that have been prepared since the balance-sheet date.

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RELATED PARTIES TRANSACTIONS

Perform the following review for related-party relationships or transactions:

- Review the results of audit procedures applied to specific accounts or other general procedures for the existence of previously unidentified related parties or related-party transactions.
- Update your inquiries of management about the existence of related parties and related-party transactions.
- If significant transactions outside the entity's normal course of business have been identified, inquire of management about the nature of the transactions and whether related parties are involved.

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RELATED PARTIES TRANSACTIONS

If procedures performed reveal the existence of previously undisclosed related parties or related-party transactions perform the following procedures:

- (1) Consider the effect on your risk assessment, including fraud risks, and the need to perform additional procedures.
- (2) Request management to identify all transactions with the newly identified related parties.
- (3) Inquire why controls over related-party relationships and transactions failed to identify or disclose such relationships or transactions.
- (4) If evidence indicates that nondisclosure of related parties or related-party transactions appears intentional, consider the need to reevaluate the reliability of management's audit inquiries and representations and evaluate the implications for the audit.

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RELATED PARTIES TRANSACTIONS

- Obtain an understanding of the business purpose of significant related-party transactions. Consider whether transactions, especially those involving unconsolidated related parties, have been reviewed and approved at an appropriate level.
- Update the lists of related parties and related-party transactions throughout the engagement and communicate changes to all engagement team members and any component auditors.
- If management has made an assertion in the financial statements that a related-party transaction was conducted at arm's length, obtain sufficient appropriate audit evidence to support such assertion.
- Consider whether the accounting for related-party transactions is appropriate. Based on procedures performed, ensure that the workpapers include the information needed to support financial statement disclosures about related parties.

141

SUPPLEMENTARY INFORMATION

- Evaluate the presentation of supplementary information in relation to the financial statements as a whole by performing the following procedures:
- Determine that the criteria have been met to permit reporting on supplementary information.
- Inquire of management about the purpose of the supplementary information, the criteria used to prepare it, and any significant assumptions or interpretations underlying the measurement or presentation of the information.
- Determine that the form and content of the supplementary information complies with the applicable criteria.

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SUPPLEMENTARY INFORMATION

- Obtain an understanding of the methods used to prepare the supplementary information and determine whether the preparation methods are consistent with those used in prior years (or if preparation methods have changed from those used in prior periods, the reason for those changes).
- Compare and reconcile the supplementary information to the financial statements or the underlying accounting and other records.
- Evaluate the appropriateness and completeness of the supplementary information, considering the results of procedures and knowledge obtained during the audit of the financial statements.

143

EVALUATION AND COMPLETION PROCEDURES

- Consider whether conditions and events have been identified, either through management's evaluation or through audit procedures performed, that, when considered in the aggregate, indicate there could be substantial doubt about the entity's ability to continue as a going concern.
- If so, complete ASB CX 16.1 and apply any necessary audit procedures to obtain audit evidence about identified conditions and events, management plans for dealing with the adverse effects of the conditions and events, or prospective information particularly significant to management's plans.

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EVALUATION AND COMPLETION PROCEDURES

Apply the following final review analytical procedures to audited financial statement amounts:

- Compare financial statement line items for the current and preceding period, analyze the results, and explain significant changes.
- Update the preliminary analytical review of revenues performed during audit planning through the end of the reporting period, if not already done.
- Consider the adequacy of evidence gathered in response to unusual or unexpected balances or relationships identified while performing preliminary or final analytical procedures.
- Consider whether responses to inquiries throughout the audit about analytical relationships have been vague or implausible or have produced evidence that is inconsistent with other audit evidence accumulated during the audit.

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EVALUATION AND COMPLETION PROCEDURES

- Summary of Audit Differences
- Accumulate and evaluate misstatements identified during the audit, other than those that are clearly trivial, by completing ASB CX12.2 .
- Unadjusted Audit differences get placed on CX12.2.
- If adjustments posted goes on summary of posted adjustments have management approve and sign off.
- If no unadjusted audit differences place in file and document none noted.

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EVALUATION AND COMPLETION PROCEDURES

- Obtain a written representation letter from management.
- Verify financial statement captions flow through from financial statements through the management representation letter.
- If management does not engage legal counsel include in representation letter.

147

EVALUATION AND COMPLETION PROCEDURES

- Complete a financial statement disclosure checklist.
- Useful tool if used effectively
- Should be completed once financial statements are completed.
- Review disclosure checklist and verify all items that should be disclosed are disclosed.
- Either the disclosure applies and should be marked yes or does not apply and should be marked N/A.
- There should be no no answers on the disclosure checklist.

148

EVALUATION AND COMPLETION PROCEDURES

- Demonstrate in the workpapers that the accounting records agree or reconcile with the financial statements and the disclosures subject to auditing procedures.
- Read drafts of the financial statements and related notes for appropriate account classifications, clarity, and understandability.
- Evaluate the consistency of the financial statements.
- Draft the auditor's report on the financial statements after considering any GAAP departures, scope limitations, component auditors, consistency, or other matters.

149

EVALUATION AND COMPLETION PROCEDURES

- Summarize internal control related matters for communication to management and those charged with governance. Summarize other management points for possible communication. CX 15.1
- If there are internal control matters they must be disposed of properly.
- Communicate significant audit findings to those charged with governance or management (if all of those charged with governance are involved in management).

150

EVALUATION AND COMPLETION PROCEDURES

- Document supervision of staff and review of the audit work and financial statements, including engagement quality control review, in accordance with firm policies by completing ASB CX 14.
- Consistency between detailed review and technical review.
- Engagement quality control review (EQCR).

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SUBSTANTIVE PROCEDURES

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OVERARCHING PRINCIPLES

- **IF IT WAS NOT DOCUMENTED IT WAS NOT DONE**

STANDARD WE ARE HELD TO:

- SOMENONE NOT FAMILIER WITH THE ENGAGEMENT SHOULD BE ABLE TO
- UNDERSTAND THE WORK WE HAVE DONE
- FOLLOW THE WORK WE HAVE DONE
- REACH THE SAME CONCLUSION WE HAVE MADE

2

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SUBSTANTIVE PROCEDURES

HOW DO WE GET TO A POINT THAT?

- SOMENONE NOT FAMILIER WITH THE ENGAGEMENT SHOULD BE ABLE TO
- UNDERSTAND THE WORK WE HAVE DONE
- FOLLOW THE WORK WE HAVE DONE
- REACH THE SAME CONCLUSION WE HAVE MADE

154

SUBSTANTIVE PROCEDURES

- Best Practices to document the following
- Purpose
- Procedures
- Conclusion

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SUBSTANTIVE PROCEDURES

- Purpose-What is this workpaper doing in the audit file?
- Purpose: The purpose of the cash workpapers is to verify cash is properly stated on the ABC financial statements

156

SUBSTANTIVE PROCEDURES

- Procedures- What did the auditor do?
- Procedures: (Cash)
 1. Obtained bank reconciliation.
 2. Mathematically tested the bank reconciliation and verified the bank reconciliation was prepared timely.
 3. Confirmed the bank balance with financial institution.
 4. Traced and agreed the book balance to the trial balance and the bank balance to the bank statement and cash confirmation.
 5. Traced outstanding checks and deposits in transit to the following months bank statement.

157

SUBSTANTIVE PROCEDURES

- Conclusion- Provides the linkage between the procedures the auditor performed and how auditor concluded in relation to a particular account.
- Conclusion: Based on the procedures performed cash appears to be properly stated on the ABC financial statements.

158

SUBSTANTIVE PROCEDURES

Unless the procedures are in “left field”

- SOMENONE NOT FAMILIER WITH THE ENGAGEMENT CAN BE ABLE TO :
- UNDERSTAND THE WORK WE HAVE DONE
- FOLLOW THE WORK WE HAVE DONE
- REACH THE SAME CONCLUSION WE HAVE MADE

159

SUBSTANTIVE PROCEDURES

Cash

Perform the following bank reconciliation procedures:

- Obtain the bank reconciliation for significant bank accounts for the workpapers.
- Trace the bank balance on the reconciliation to the balance per the bank statement (or confirmations received).
- Trace the reconciled book balance to the general ledger, working trial balance, or lead schedule as applicable.
- Test the clerical accuracy of the reconciliation.
- Scan the bank reconciliation for significant or unusual reconciling items. Obtain explanations and review supporting documentation for any unusual reconciling items noted.

160

SUBSTANTIVE PROCEDURES

Cash

Perform the following analytical procedures:

- Scan cash receipts and disbursements for significant or unusual transactions (including any bank transfers) near year end.
- Obtain explanations and review supporting documentation, as necessary, for any such items noted.
- Obtain explanations for significant account variations from the prior period.
- Assess the reasonableness of cash balances in light of your understanding of the business and current operating results.

161

SUBSTANTIVE PROCEDURES

Cash

Perform the following confirmation procedures:

- Confirm selected bank account(s), certificates of deposit, money market investments, and compensating balances as of the balance sheet date. Document the items selected for confirmation.
- Tie confirmation amounts to bank reconciliations or the general ledger as appropriate. Investigate exceptions.
- Consider the possibility of unrecorded interest or substitution of certificate numbers for cash investments.

162

SUBSTANTIVE PROCEDURES

- Cash
- Determine whether amounts are appropriately classified as cash, cash equivalents, or other short-term investments.

Concluding Audit Steps

- Ensure that the workpapers include the information needed to support required financial statement disclosures and such information has been subjected to appropriate audit procedures.
- Consider the need to apply one or more additional procedures and whether the results of audit procedures indicate internal control related matters that are required to be communicated to management and others.

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SUBSTANTIVE PROCEDURES

Cash

Conclusion

- We have performed procedures and obtained audit evidence sufficient to provide reasonable assurance about cash (to support our opinion on the financial statements taken as a whole). The procedures performed, evidence obtained, and our conclusions are adequately documented. (If you are unable to conclude, prepare a memo documenting your reason and the implications for the engagement, including the audit report.)

164

SUBSTANTIVE PROCEDURES

Accounts Receivable and Sales

Perform the following analytical procedures:

- Compare the balance in trade accounts receivable with the balance for prior periods or other expectation.
- Investigate any unexpected results (that is, ratios or variations different from what would be expected), considering known changes in client or industry operations or business conditions, such as price changes, etc.

165

SUBSTANTIVE PROCEDURES

Accounts Receivable and Sales

- Review a reconciliation of the aged accounts receivable trial balance to the general ledger account balance. Obtain and document an explanation for any unusual reconciling items. Review documentation supporting reconciling items and explanations, as considered necessary.
- Scan the trial balance for unusual items or items that might require reclassification in the balance sheet. Discuss such items with the client and if necessary review supporting documentation and propose reclassifications.

166

SUBSTANTIVE PROCEDURES

Accounts Receivable and Sales

Perform the following confirmation procedures:

- Select accounts to be confirmed from the aged trial balance. Document the items selected for confirmation.
- Have positive confirmation requests prepared and control sending out the confirmations.
- Send second requests to nonreplies.
- Reconcile differences reported on confirmation replies. Examine supporting documentation for reconciling items (remittance advices, deposit slips, invoices, shipping documents, etc.) as considered necessary.
- Perform alternative procedures on nonreplies.
- Investigate exceptions to determine whether they are indicative of misstatements. Evaluate the results of the confirmation procedures.

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SUBSTANTIVE PROCEDURES

Accounts Receivable and Sales

Test the adequacy of the allowance for doubtful accounts by performing the following procedures:

- Update your understanding obtained during planning of the client's process for estimating the allowance, if necessary.

168

SUBSTANTIVE PROCEDURES

Accounts Receivable and Sales

- Compute one or more of the following ratios; compare the balances and ratios computed to those for prior periods or other expectations; and investigate any unusual relationships or trends (that is, ratios or trends different from what would be expected, considering known changes in client or industry operations or business conditions):

169

SUBSTANTIVE PROCEDURES

Accounts Receivable and Sales

- Comparison of the balances in the allowance for doubtful accounts, sales returns and allowances, and bad debts expense with the amounts for prior periods or other expectations.
- The allowance as a percentage of accounts receivable.
- The age of receivables $[(\text{average net receivables} \times 365) \div \text{net credit sales}]$.
- Each aging category (under 30 days, 30–60 days, etc.) as a percentage of total receivables.

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SUBSTANTIVE PROCEDURES

Accounts Receivable and Sales

- Inquire whether collection problems are likely to occur with accounts that are presently classified as current (for example, customer disputes or financial solvency issues).
- Determine whether there are sold, pledged, discounted, or assigned receivables based on inquiry of the client and the consideration of work performed in other areas, such as reviews of confirmation replies from financial institutions, loan agreements, and minutes. Summarize information needed for financial statement disclosure.

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SUBSTANTIVE PROCEDURES

Accounts Receivable and Sales

Sales

- If considered necessary, update your understanding obtained during planning of the client's revenue recognition policies and determine that they are in accordance with GAAP. Inquire of management about, and evaluate, changes in revenue recognition policies.

172

SUBSTANTIVE PROCEDURES

Sales

Perform the following analytical procedures:

- Obtain a schedule for the workpapers summarizing sales, sales returns, and allowances at an appropriate level of detail (for example, by major product line, geographic location, or other meaningful division), in total and by meaningful interim period (monthly, quarterly, etc.). Agree or reconcile the total to the general ledger.

173

SUBSTANTIVE PROCEDURES

Sales

Perform one or more of the following procedures:

- Compare amounts to those of prior periods or other expectations.
- Compare actual amounts to budgeted amounts.
- Compute other ratios or expectations unique to the industry or client (describe):
- Investigate any unexpected results (that is, ratios or variations different from what would be expected), considering known changes in client or industry operations or business conditions, such as price and volume changes, seasonal fluctuations, trends, etc.

174

SUBSTANTIVE PROCEDURES

Sales

- Scan the sales journal and investigate large or unusual transactions near year end (both before and after). Discuss such items with the client, review supporting documentation, and propose adjusting or reclassifying entries if considered necessary.

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SUBSTANTIVE PROCEDURES

Sales

Concluding Audit Steps

- Ensure that the workpapers include the information needed to support required financial statement disclosures and such information has been subjected to appropriate audit procedures.
- Consider the need to apply one or more additional procedures and whether the results of audit procedures indicate internal control related matters that are required to be communicated to management and others.

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SUBSTANTIVE PROCEDURES

Sales

Conclusion

- We have performed procedures and obtained audit evidence sufficient to provide reasonable assurance about accounts receivable and sales (to support our opinion on the financial statements taken as a whole). The procedures performed, evidence obtained, and our conclusions are adequately documented. (If you are unable to conclude, prepare a memo documenting your reason and the implications for the engagement, including the audit report.)

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SUBSTANTIVE PROCEDURES

Accounts Receivable- Extended Procedures

Perform the following procedures on the aged trial balance:

- Test the clerical accuracy.
- Test the accuracy of the aging categories for individual accounts by tracing amounts in each category to detail in the subsidiary ledger and to underlying sales invoices and collection documentation

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SUBSTANTIVE PROCEDURES

- Accounts Receivable
- Expand confirmations for high risk receivable categories, such as receivables for complex transactions, receivables for customers that historically have received adjustments or were slow to pay, receivables for customers that receive nonstandard terms, or new customer receivables.
- Confirm additional information with the customer, such as any special sale or payment terms extended to the customer or certain relevant contract terms.

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SUBSTANTIVE PROCEDURES

Accounts Receivable

Modify the follow-up and alternative procedures for nonreplies by performing the following procedures:

- Increase the number of follow-up attempts, including phone calls to obtain the confirmation.
- When examining supporting invoices and shipping documentation for nonreplies with no subsequent cash receipts, also examine supporting documentation regarding the nature of the billed transaction, underlying sales terms, and customer history.

180

SUBSTANTIVE PROCEDURES

Accounts Receivable

Perform the following procedures (generally as a response to identified fraud risks):

- Verify customer addresses, both physical and electronic, by selecting large accounts and independently tracing them to phone or business directories, phone calls to customers, documents received from customers, credit checks, etc.
- Make oral inquiries of customers in addition to sending written confirmations.
- Verify the validity of nontraditional confirmation replies, such as those received by fax or email.
- Send confirmation requests to specific individuals at the customer whose authenticity has been verified.

181

SUBSTANTIVE PROCEDURES

Accounts Receivable

Perform the following analytical procedures:

- Compute the ratio of accounts receivable to current assets, total assets, and/or net worth and compare to the ratios for prior periods or other expectations.
- Obtain from the client an analysis of days sales outstanding by major customer category and compare the results to those of prior periods or other expectation.
- Investigate any unexpected results (that is, ratios or variations different from what would be expected), considering known changes in client or industry operations or business conditions, such as price changes, etc

182

SUBSTANTIVE PROCEDURES

Test of Allowance for Doubtful Accounts

Perform the following procedures to test the allowance for doubtful accounts:

- Obtain and review an analysis of the allowance account and bad debt expense account. Consider, and discuss with the client, the reasonableness of write-offs and recoveries.
- Review the aged trial balance with subsequent collections, credit memos, and write-offs posted on it and discuss with the client balances over 90 days that have not been subsequently cleared. If considered necessary, review supporting documentation for client explanations, such as credit files, customer correspondence, etc.

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SUBSTANTIVE PROCEDURES

Test of Allowance for Doubtful Accounts

- Consider whether credit memos or write-offs after the balance-sheet date indicate that an account was doubtful as of the balance-sheet date.
- Test subsequent collections posted to the aged trial balance for major account balances by examining deposit slips and remittance advices and matching cash receipts to specific invoices. Document the account balances selected for testing.

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SUBSTANTIVE PROCEDURES

Test of Allowance for Doubtful Accounts

- Examine documentation supporting write-offs and adjustments to individual accounts and the allowance account (client approvals, credit memos, etc.). Document the items tested.
- For significant delinquent balances, consider evaluating the debtor's creditworthiness and the value of any collateral pledged to secure the receivable.
- Estimate a range of allowance for doubtful accounts that would be acceptable. Compare the range to the allowance and challenge any difference between the client's amount and the closest amount in the acceptable range.

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SUBSTANTIVE PROCEDURES

Sales

- Test the clerical accuracy of the schedule of sales, sales returns, and allowances obtained for the workpapers.

Using a schedule summarizing sales, sales returns, and allowances at an appropriate level of detail (for example, by major product line, geographic location, or other meaningful division), in total and by meaningful interim period (monthly, quarterly, etc.) for the year perform one or more of the following analytical procedures:

- Compare amounts between interim periods.

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SUBSTANTIVE PROCEDURES

Sales

- Compute the ratio of sales returns and allowances to gross sales at a detail level and in total.
- Investigate any unexpected results (that is, ratios or variations different from what would be expected based on seasonal fluctuations, trends, and prior year results), considering known changes in client or industry operations or business conditions, such as price and volume changes, etc. Document the considerations and evaluation of related explanations.

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SUBSTANTIVE PROCEDURES

Sales

- Using the schedule of sales, sales returns, and allowances obtained for the workpapers, perform a predictive test of sales at an appropriate level of detail (for example, by product line, geographic location, or other meaningful division), and compare the results with the amount recorded in the accounts. Investigate significant or unusual differences.

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SUBSTANTIVE PROCEDURES

Tests of Sales Details

Considering the nature of the revenue sources and related revenue transactions, the assessed level of risk of material misstatement for the relevant assertions, and the results and precision of the substantive analytical procedures (including related accounts receivable procedures), perform the following:

- Select and document significant revenue transactions recorded during the year.
- Examine supporting contracts, shipping documents, or other documentation to determine that revenue was properly recognized in the correct period.
- Determine the propriety of amounts recognized and that amounts were properly approved.

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SUBSTANTIVE PROCEDURES

Test of Sales Completeness

- Inquire of management as to steps taken to ensure the trial balance is complete, i.e., that all receivables due the entity are included on the trial balance or all sales of the entity have been recorded.

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SUBSTANTIVE PROCEDURES

Perform the following procedures as a test of sales completeness:

- Select a sample of original shipping documents. Document the items tested.
- Trace the information on the documents to the related sales invoices. Determine that details are appropriately reflected on the invoice.
- Determine that the total amount of sales reported on the invoice is properly computed and approved.
- Trace the amounts on sales invoices to proper recording in the sales journal or general ledger, as appropriate.
- Determine that proper accounting treatment has been applied to these sales transactions.

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SUBSTANTIVE PROCEDURES

Test of Sales Cutoff

- Scan the sales journals for month(s) before and after the balance-sheet date. Investigate any unusual entries.
- Review the journal for sales returns and credit memos for month(s) before and after the balance-sheet date. Investigate any unusual entries.
- Compare sales for the last month of the year to sales for the rest of the year and the first month after year end.
- Compare monthly sales returns and credit memos for the last few months of the fiscal year to the first few months following year-end.
- Investigate the nature and cause of any significant differences disclosed by the preceding comparisons (that is, variations different from what would be expected, considering known changes in client or industry operations or business conditions).
- Trace the shipping documents for the last shipments before year end and the first shipments after year end obtained during the physical inventory observation to the sales journal to determine whether they were recorded in the proper period.

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SUBSTANTIVE PROCEDURES

Test of Sales Cutoff

Perform the following procedures related to sales cutoff (generally as a response to identified fraud risks):

- If there is an identified risk of material misstatement due to fraud involving improper revenue recognition, consider inquiring of sales and marketing personnel about sales or shipments near year end and their knowledge of unusual terms or conditions related to those transactions.
- Compare revenues recorded daily for the periods shortly before and after the balance-sheet date for unusual fluctuations.
- Compare monthly cash receipts during the year to cash receipts subsequent to year end to determine if receipts subsequent to the balance-sheet date are unusually low compared to the collection history during the months under audit.
- Vouch large or unusual sales made at year end to original source documents.
- In conjunction with the tour of the shipping and receiving area during inventory observation, consider physically observing goods being shipped or readied for shipment, or returns awaiting processing, at the balance-sheet date.

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SUBSTANTIVE PROCEDURES

Property

Perform the following analytical procedures:

- Obtain a schedule that summarizes the opening and ending balances in each property and related accumulated depreciation and amortization account and the transactions in each account (additions and retirements, depreciation and amortization expense, transfers or other adjustments, etc.) and that describes the depreciation and amortization methods and lives.
- Compare activity and balances in the property and accumulated depreciation and amortization accounts with the activity and balances for prior periods or other expectations such as the capital budget.
- Compute ratios unique to the industry or client (describe):
- Investigate any unexpected results noted while performing the preceding analytical procedures (that is, ratios or variations different from what would be expected), considering known changes in client operations.

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SUBSTANTIVE PROCEDURES

Property

- Consider whether all significant additions (purchased, self-constructed, or acquired under capital lease) and dispositions (sales, retirements, or abandonments) are reflected in the accounting records and whether material additions are the property of the entity based on your understanding of the entity, inquiries of management, and work performed in other areas (such as the review of directors' minutes and significant new leases or other contracts and physical observation).

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SUBSTANTIVE PROCEDURES

Property

Test the adequacy of current-year depreciation and amortization expense by performing the following procedures.

- If considered necessary, update your understanding obtained during planning about whether there has been any change in depreciation or amortization lives or methods. Inquire about whether there are significant amounts of fully depreciated or amortized assets.
- Scan the schedule of property opening and ending balances and transactions and consider whether useful lives of assets are reasonable, whether depreciation and amortization methods are in accordance with GAAP and consistent, and whether depreciation and amortization expense for the period appears reasonable.
- Cross-reference depreciation credited to the various allowance accounts to depreciation reflected in the expense accounts.

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SUBSTANTIVE PROCEDURES

Property

- Considering information obtained in other procedures, knowledge of client operations and business conditions, and information obtained during facility tours or inventory observations, evaluate whether the remaining useful lives of assets are reasonable and the net carrying values of property are recoverable in the ordinary course of business.

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SUBSTANTIVE PROCEDURES

Property

Concluding Audit Steps

- Ensure that the workpapers include the information needed to support required financial statement disclosures and such information has been subjected to appropriate audit procedures.
- Consider the need to apply one or more additional procedures and whether the results of audit procedures indicate internal control related matters that are required to be communicated to management and others.

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SUBSTANTIVE PROCEDURES

Property

Conclusion

- We have performed procedures and obtained audit evidence sufficient to provide reasonable assurance about property (to support our opinion on the financial statements taken as a whole). The procedures performed, evidence obtained, and our conclusions are adequately documented. (If you are unable to conclude, prepare a memo documenting your reason and the implications for the engagement, including the audit report.)

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SUBSTANTIVE PROCEDURES

Other Assets

- Compare balances in the asset and any expense amortization accounts with those of prior periods, budgets, or other expectations. Explain unusual variations (that is, variations different from what would be expected) and examine support for explanations as necessary.
- Determine the proper financial statement descriptions and, where applicable, classifications between current and noncurrent assets.
- Inquire about any liens or restrictions on the assets.

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SUBSTANTIVE PROCEDURES

Other Assets

Prepays, Deferred Charges, and Intangibles

- Review the nature of each significant account and evaluate whether it is appropriate to allocate such cost to future periods. Also consider the consistency of application of GAAP (for example, whether any items were treated as assets in the current period and expensed in prior periods, and vice versa).

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SUBSTANTIVE PROCEDURES

Other Assets

Prepays, Deferred Charges, and Intangibles

Perform the following procedures:

- Determine the reasonableness of remaining asset balances and remaining amortization lives.
- If not already considered during the performance of planning procedures, determine whether the amortization methods are in accordance with GAAP and are consistent with those of prior periods. If there are differences between the book and tax amortization methods, determine that they are considered in deferred taxes (see the audit program for income taxes).
- Inquire about whether goodwill and other intangibles have been tested for impairment and review the results of impairment tests.

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SUBSTANTIVE PROCEDURES

Other Assets

Prepays, Deferred Charges, and Intangibles

Concluding Audit Steps

- Ensure that the workpapers include the information needed to support required financial statement disclosures and such information has been subjected to appropriate audit procedures.
- Consider the need to apply one or more additional procedures and whether the results of audit procedures indicate internal control related matters that are required to be communicated to management and others.

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SUBSTANTIVE PROCEDURES

Other Assets

Prepays, Deferred Charges, and Intangibles

Conclusion

- We have performed procedures and obtained audit evidence sufficient to provide reasonable assurance about other assets (to support our opinion on the financial statements taken as a whole). The procedures performed, evidence obtained, and our conclusions are adequately documented. (If you are unable to conclude, prepare a memo documenting your reason and the implications for the engagement, including the audit report.)

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SUBSTANTIVE PROCEDURES

Accounts Payable

- Compare the balances in trade accounts payable and purchases with those of prior periods or other expectations. Relate the level of activity to inventory levels and sales volume. Investigate any unusual fluctuations, considering known changes in client operations.

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SUBSTANTIVE PROCEDURES

Accounts Payable

Perform the following accounts payable procedures:

- Obtain a listing of trade accounts payable as of the balance-sheet date. Agree or reconcile the balance to the general ledger.
- Scan the listing and investigate any unusual or old items.
- Scan the listing for related-party accounts payable. Gather information for appropriate financial statement disclosure.

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SUBSTANTIVE PROCEDURES

Accounts Payable

With respect to unrecorded liabilities, do the following:

- If considered necessary, update your understanding obtained during planning by inquiring of responsible client personnel about (1) procedures for processing invoices and the consistency of such procedures with those of prior years and (2) their knowledge of additional sources of unprocessed invoices, commitments, or contingent liabilities and whether accruals have been made for such items as of the balance-sheet date. (See the separate general program at for additional procedures to detect commitments and contingent liabilities and to review for subsequent events.)
- Trace receiving cutoff information obtained during inventory observation to the accounting records, noting whether the liability for the merchandise is recorded in the proper accounting period.

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SUBSTANTIVE PROCEDURES

Accounts Payable

Perform a search for unrecorded liabilities by performing the following procedures:

- Obtain and examine supporting detail for material disbursements after the balance-sheet date and determine whether the goods or services on the paid invoices were received on or before the balance-sheet date. If so, determine whether the liability is recorded. Document the source and selection criteria for items tested. (If the entity uses a voucher register, consider performing these procedures on material transactions vouchered after the balance-sheet date.)
- Inspect files of unprocessed (or unvouchered) invoices, vendor statements, and unmatched receiving documents. If the goods or services were received on or before the balance-sheet date, determine whether the liability is included in the accounts payable listing (or the listing of accrued liabilities).
- Relate the findings in the search for unrecorded liabilities to the accrued balances.

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SUBSTANTIVE PROCEDURES

Accruals and Other Liabilities

- Compare the balances in accrued liabilities with those of prior periods or other expectations. Investigate any unusual fluctuations, considering known changes in client operations.

Test accruals and other liabilities by performing the following procedures:

- Scan the working trial balance and determine those accrual or other liability accounts for which additional testing should be performed.
- Determine the basis and method of accrual.
- Test the reasonableness of the accrual by performing a predictive test of the amount.
- Consider whether immaterial balances are reasonable and whether any needed accruals are missing.

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SUBSTANTIVE PROCEDURES

Accruals and Other Liabilities

- Scan the expense accounts in the working trial balance and compare their balances to prior-period balances or other expectations. Investigate unusual fluctuations (that is, variations different from what would be expected, considering known changes in client operations or economic conditions) or the absence of accrued expense items that existed in the prior period that may indicate an unrecorded accrual. (This work should be coordinated with the audit of expense accounts.)
- Consider whether the entity has financial instruments with characteristics of both liabilities and equity that should be classified as liabilities in the balance sheet. (Coordinate this step with testing performed in the equity audit program.)

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SUBSTANTIVE PROCEDURES

Accruals and Other Liabilities

Concluding Audit Steps

- Ensure that the workpapers include the information needed to support required financial statement disclosures and such information has been subjected to appropriate audit procedures.
- Consider the need to apply one or more additional procedures and whether the results of audit procedures indicate internal control related matters that are required to be communicated to management and others.

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SUBSTANTIVE PROCEDURES

Accruals and Other Liabilities

Conclusion

- We have performed procedures and obtained audit evidence sufficient to provide reasonable assurance about accounts payable and other liabilities (to support our opinion on the financial statements taken as a whole). The procedures performed, evidence obtained, and our conclusions are adequately documented. (If you are unable to conclude, prepare a memo documenting your reason and the implications for the engagement, including the audit report.)

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SUBSTANTIVE PROCEDURES

Notes Payable and Long-Term Debt

Using an analysis of notes payable, long-term debt, capitalized lease obligations, and other financing transactions or arrangements, such as lines of credit, perform the following procedures:

- Compare balances in the liability accounts and related interest expense with those of prior periods or other expectations.
- Compare balances in the liability accounts to debt amortization schedules and, if applicable, to the terms of new debt agreements.
- Investigate any unexpected results (that is, ratios or variations different from what would be expected), considering known changes in client operations.

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SUBSTANTIVE PROCEDURES

Notes Payable and Long-Term Debt

- Analytically test the reasonableness of interest expense and accrued interest payable for the period by an overall calculation, based on the average principal amounts outstanding during the period and contractual or average interest rates. Explain unusual variations and examine support for explanations as necessary.
- Consider the need to impute interest on noninterest bearing notes.
- Compare debt terms and debt balances as of the balance-sheet date to amounts confirmed on the standard bank confirmations sent when performing audit procedures for cash.

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SUBSTANTIVE PROCEDURES

Notes Payable and Long-Term Debt

- Review loan and debt agreements and determine whether assets are pledged and whether there are any restrictive covenants. Determine whether the entity is in compliance with restrictive covenants. Make financial statement disclosure points for pledged assets and loan restrictions.
- Determine the current portion of long-term debt. Summarize in the workpapers the disclosures for note terms, interest rates, and maturities over the next five years.
- If considered necessary, update your understanding obtained during planning of whether the entity has converted interest-bearing debt from fixed to variable or variable to fixed using derivatives, has entered into interest rate protection agreements using swaps, caps, or collars, or has issued debt with an embedded conversion option and warrants that should be accounted for as derivatives.

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SUBSTANTIVE PROCEDURES

Notes Payable and Debt

Concluding Audit Steps

- Ensure that the workpapers include the information needed to support required financial statement disclosures and such information has been subjected to appropriate audit procedures.
- Consider the need to apply one or more additional procedures and whether the results of audit procedures indicate internal control related matters that are required to be communicated to management and others.

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SUBSTANTIVE PROCEDURES

Notes Payable and Debt

Conclusion

- We have performed procedures and obtained audit evidence sufficient to provide reasonable assurance about notes payable and long-term debt (to support our opinion on the financial statements taken as a whole). The procedures have been performed, evidence obtained, and our conclusions are adequately documented. (If you are unable to conclude, prepare a memo documenting your reason and the implications for the engagement, including the audit report.)

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SUBSTANTIVE PROCEDURES

Income Taxes

- Using an analysis of income tax related accounts and related tax return information, perform the following procedures:
- Check the mathematical accuracy of the schedule and trace the beginning and ending balances to the working trial balance.
- Scan the accounts and compare opening balances to the prior year's workpapers.
- Review the prior year's tax return and compare taxes payable or refundable per the return to the amount recorded in that year. Determine the reason for any significant difference and that any necessary accounting adjustments were made.
- Review the results of any IRS examinations completed during the period. Determine that any necessary accounting adjustments were made.

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SUBSTANTIVE PROCEDURES

Income Taxes

Review the calculation of the provision for income taxes by performing the following procedures:

- Check the mathematical accuracy of the calculation.
- Reconcile income before taxes per the financial statements to taxable income per the workpaper or tax return.
- Reconcile the effective tax rate to the statutory rate and determine the reason for any significant difference.

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SUBSTANTIVE PROCEDURES

Income Taxes

Perform the following procedures for uncertain tax positions:

- Determine whether current and deferred tax provisions exclude any tax benefit from significant tax positions for which there is no greater than a 50% chance of being sustained upon examination.
- For other significant tax positions, determine whether current and deferred tax provisions include the largest amount of tax benefit for which there is greater than a 50% chance of realization upon ultimate settlement with the taxing authority.
- Determine whether changes in the liability for unrecognized tax benefits related to positions taken in prior years are appropriately computed and recognized.
- Determine whether appropriate penalties and interest have been recognized for the liability for unrecognized tax benefits.

Determine that all necessary permanent and temporary differences are reflected in the calculation and are consistent with those of prior years.

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SUBSTANTIVE PROCEDURES

Income Taxes

Evaluate the adequacy of the amount for income taxes payable in the balance sheet by performing the following procedures:

- Discuss the status of any IRS examination in progress with client personnel.
- Determine that the classification of any unrecognized tax benefits liability is appropriate.
- If considered necessary, obtain for the workpapers and review a roll-forward of changes in the liability for unrecognized tax benefits.
- If applicable, obtain access to opinions from outside tax advisors supporting the recognition and measurement of uncertain tax positions. Document the facts and conclusions reached.
- Assess the adequacy of the balance of taxes payable, including the liability for unrecognized tax benefits, in light of possible assessments for disputable items in this year's return and any open prior years, including possible penalties and interest. (Discuss such items with client personnel.)

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SUBSTANTIVE PROCEDURES

Income Taxes

- Consider the classification of the deferred tax asset or liability by current and noncurrent amounts for entities that have not yet implemented ASU 2015-17, *Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes*. For entities that have early-adopted ASU 2015-17, determine whether the deferred tax asset or liability is properly presented as noncurrent.

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SUBSTANTIVE PROCEDURES

Income Taxes

Evaluate whether it is more likely than not that deferred tax assets will be realized by performing the following procedures:

- Determine whether there is both negative and positive evidence regarding whether the deferred tax asset will be realized.
- If there is only positive evidence that the deferred asset will be realizable, and the entity historically has been profitable and has paid taxes:
- Inquire of management and assess whether this trend is likely to continue.
- If it is determined that the trend is likely to continue, document in the workpapers the reason a valuation allowance is not needed.

If there is both negative and positive evidence that the deferred asset will be realizable:

- Evaluate the client's calculations and rationale regarding a need for a valuation allowance or, if not available, prepare an analysis of taxable income to determine if a valuation allowance is needed.
- Conclude and document (a) the rationale for the valuation allowance or (b) that a valuation allowance is not required.

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SUBSTANTIVE PROCEDURES

Income Taxes

Concluding Audit Steps

- Ensure that the workpapers include the information needed to support required financial statement disclosures and such information has been subjected to appropriate audit procedures.
- Consider the need to apply one or more additional procedures and whether the results of audit procedures indicate internal control related matters that are required to be communicated to management and others.

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SUBSTANTIVE PROCEDURES

Income Taxes

Conclusion

- We have performed procedures and obtained audit evidence sufficient to provide reasonable assurance about income taxes (to support our opinion on the financial statements taken as a whole). The procedures performed, evidence obtained, and our conclusions are adequately documented. (If you are unable to conclude, prepare a memo documenting your reason and the implications for the engagement, including the audit report.)

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SUBSTANTIVE PROCEDURES

Equity

- If not already done in other audit areas, read the directors' or partners' minutes and note equity transactions authorized.

Using an analysis of transactions in equity accounts (capital stock issued and outstanding, treasury stock, paid-in-capital, dividends, and retained earnings) during the period under audit, perform the following procedures:

- Check the clerical accuracy of the schedule and trace the beginning and ending balances to the working trial balance.
- Compare the balances with those of prior periods or other expectation, considering known changes in client operations and equity financing activity. Investigate unexpected differences.
- Identify the number of shares held in treasury and examine certificates.

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SUBSTANTIVE PROCEDURES

Equity

Test significant transactions included in the analysis of equity accounts by performing the following procedures:

- Examine supporting documents for significant transactions affecting capital stock, paid-in capital, contributed capital, or treasury stock. Document the items tested.
- Consider whether such transactions are in accordance with the entity's charter, applicable state regulations, partnership agreement, or other relevant documents.
- Determine that significant entries are accounted for in the proper period in accordance with GAAP.
- Include in the current or permanent workpaper files abstracts or copies of significant agreements or other documents examined to evaluate appropriate accounting.

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SUBSTANTIVE PROCEDURES

Equity

Test significant transactions included in the analysis of retained earnings (or equivalent) account by performing the following procedures:

- Reconcile changes in retained earnings to net income for the period and other appropriate transactions included.
- Scan the retained earnings account and be aware of unusual transactions that might indicate improper accounting or use of the tax method of accounting. These transactions should be identified for potential adjustments, if appropriate.
- Determine that declared and unpaid dividends are properly recorded.
- Determine the authorization of dividend payments or other types of entries that might affect retained earnings accounts.

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SUBSTANTIVE PROCEDURES

Equity

- Obtain an analysis of transactions affecting accumulated other comprehensive income for the period, relate the beginning and ending balances to the trial balance, and review the propriety of classifications. Agree activity to testing performed in other audit areas.

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SUBSTANTIVE PROCEDURES

Equity

Perform the following procedures for equity-related agreements:

- Obtain copies of any new company agreements associated with rights or restrictions on equity accounts, including any debt agreements, buy-sell agreements, or related options to buy company stock if not previously obtained during planning or in other audit areas.
- Review the plan documents and summarize the key terms and conditions of the agreements. Include in the current or permanent workpaper files abstracts or copies of significant agreements examined.
- Determine the nature of the agreements and their effect on the entity's equity.
- Evaluate the appropriateness of the accounting treatment under GAAP for any transactions that might be the result of such agreements.
- Where applicable, evaluate the determination of fair value assigned to instruments or features and test the allocation of proceeds.
- Determine the amount of equity balances that are restricted due to provisions in such agreements.

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SUBSTANTIVE PROCEDURES

Equity

Concluding Audit Steps

- Ensure that the workpapers include the information needed to support required financial statement disclosures and such information has been subjected to appropriate audit procedures.
- Consider the need to apply one or more additional procedures and whether the results of audit procedures indicate internal control related matters that are required to be communicated to management and others.

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SUBSTANTIVE PROCEDURES

Equity

Conclusion

- We have performed procedures and obtained audit evidence sufficient to provide reasonable assurance about equity (to support our opinion on the financial statements taken as a whole). The procedures performed, evidence obtained, and our conclusions are adequately documented. (If you are unable to conclude, prepare a memo documenting your reason and the implications for the engagement, including the audit report.)

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SUBSTANTIVE PROCEDURES

Income and Expenses

- If considered necessary, update your understanding obtained during planning of the nature of the client's business and industry and the factors that affect operations. Inquire about any major changes during the period.

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SUBSTANTIVE PROCEDURES

Income and Expenses

Perform one or more of the following analytical procedures on expense (including payroll) accounts:

- Compare balances in expense accounts with those of prior periods or other expectations.
- Compare balances in expense accounts by month and with corresponding monthly balances for the prior years.
- Compare balances in expense accounts with budgeted amounts.
- Compute the ratios of balances in relevant individual expense accounts to one or more of the totals for manufacturing expenses, selling expenses, or general and administrative expenses as appropriate in light of the client's circumstances and operations, and compare the ratios to those of prior periods or other expectations.
- Compute the percentage of selling, general, and administrative expenses to sales and compare the ratio with the ratios of prior periods or other expectation.
- Compute the ratio of payroll tax expense to total payroll and compare the ratio with the ratios of prior periods or other expectation.
- Compute other ratios unique to the industry or client (describe).

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SUBSTANTIVE PROCEDURES

Income and Expenses

Perform one or more of the following analytical procedures on other income accounts:

- Compare balances in other income accounts with those of prior periods or other expectations.
- Compare balances in other income accounts by month and with corresponding monthly balances from prior years.
- Compare balances in other income accounts with budgeted amounts.
- Compute other ratios unique to the industry or client (describe).

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SUBSTANTIVE PROCEDURES

Income and Expenses

- Investigate and document any unexpected results (that is, ratios or variations different from what would be expected), considering known changes in client or industry operations or business conditions, such as changes in the levels of production, employment, sales, prices, and payroll tax rates; seasonal fluctuations; trends; etc. From discussions with management and analysis of evidence from other audit areas, obtain and document explanations for the variations noted.
- Scan the accounting records for large and unusual transactions and review evidence obtained in other audit areas that relate to income and expense accounts. Cross-reference work done in balance-sheet areas to the related revenue and expense accounts. Obtain an understanding of the business rationale for significant or unusual transactions.

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SUBSTANTIVE PROCEDURES

Income and Expenses

Concluding Audit Steps

- Ensure that the workpapers include the information needed to support required financial statement disclosures and such information has been subjected to appropriate audit procedures.
- Consider the need to apply one or more additional procedures and whether the results of audit procedures indicate internal control related matters that are required to be communicated to management and others.

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SUBSTANTIVE PROCEDURES

Income and Expenses

Conclusion

- We have performed procedures and obtained audit evidence sufficient to provide reasonable assurance about income and expenses (to support our opinion on the financial statements taken as a whole). The procedures performed, evidence obtained, and our conclusions are adequately documented. (If you are unable to conclude, prepare a memo documenting your reason and the implications for the engagement, including the audit report.)

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PEER REVIEW UPDATE

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AGENDA

- PEER REVIEW
 - LAW AFFECTING PEER REVIEW
 - KEY PEER REVIEW POINTS
 - ENHANCED AUDIT QUALITY INITIATIVE (AICPA)
 - CHANGE TO PICPA
 - WAYS TO PREPARE FOR A PEER REVIEW

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LAW AFFECTING PEER REVIEW

- Gov. Cuomo signed the peer review bill into law on Oct. 23, 2017 firms with two or fewer CPAs that provide attest services to clients and want to continue to provide them will need to undergo a peer review every three years.

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LAW AFFECTING PEER REVIEW

- While the law went into effect immediately, the State Education Department's (SED's) New York State Board for Public Accountancy, which met on Oct. 25, 2017 in Albany, is applying its current regulation under Section [70.10](#), to firms now captured under the new law.

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LAW AFFECTING PEER REVIEW

- Section 70.10 states: *Any firm that begins providing attest services as described in Education Law section 7401-a or otherwise becomes subject to mandatory participation in the quality review program shall notify the department of its change in status within 30 days and provide the department with evidence of enrollment in an acceptable quality review program within one year of either the date of the firm's initial registration or the firm's initial performance of services requiring a quality review under this section, and the firm shall have a quality review completed within 18 months of the date such services were first provided.*

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LAW AFFECTING PEER REVIEW

- While the regulation grants firms one year to enroll in the program, the SED is encouraging firms to ***notify*** the SED ***and enroll*** in a peer review program simultaneously so that they may meet the 18-month requirement

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TIMING

- Most firms fall into one of two camps:

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TIMING

- **1. You were in the middle of an attest engagement when the law was signed on Oct. 23.** If this is the case, you have 30 days to ***notify*** the SED that you will need to have a peer review. That's 30 days from Oct. 23, 2017 so you need to notify the SED by Nov. 22 that you are currently providing this service. Because the law requires you to have a completed peer review within 18 months of Oct. 23, 2017 the SED is encouraging these firms to ***also enroll*** in a peer review in that initial 30-day period as well because the process, especially the first time, can be a lengthy one. However, there is nothing preventing a firm from notifying and enrolling immediately if you know and/or plan to continue offering attestation services.

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TIMING

- **2. You were not in the middle of an ATTEST engagement on Oct. 23, 2017 and you have not become engaged between Oct. 23, 2017 and today.** If you have no intention of doing attest work in the future, you do not have to do anything. In fact, if you issued your audit report on Oct. 22, 2017 the day before the bill was signed, you are not captured by the peer review law. What triggers your notification/peer review requirement is the date of a signed engagement letter after Oct. 23, 2017. Once you take on that attest engagement, that's what sets the 30-day and 18-month clocks ticking (see Regulation 70.10 above). For example, if are engaged to provide attest services on Dec. 1, 2017, you would have until Dec. 30, 2017 to notify the SED and presumably enroll and then 18-months from Dec. 1 (May 1, 2019) to have a completed peer review.

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HOW TO NOTIFY THE SED

- **In order to satisfy the requirement of notifying the SED,** a firm only needs to email the office; however, if a firm wishes to notify the SED through a formal letter, it may do so, at the following physical or email address:

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HOW TO NOTIFY THE SED

- NY State Education Department
Office of the Professions
State Board for Public Accountancy
89 Washington Avenue
Albany, New York 12234-1000
Phone: 518-474-3817, ext. 160
Fax: 518-474-6375
E-mail: cpabd@nysed.gov

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HOW TO ENROLL IN A PEER REVIEW

- Firms looking to enroll in peer review should visit the AICPA's PRIMA page at <http://www.aicpa.org/InterestAreas/PeerReview/Pages/PRIMA.aspx>. On that page, click on the link "Getting Started in PRIMA," for instructions on how to create an account and enroll. By enrolling, a firm agrees to have a peer review of its accounting and auditing practice once every three years.

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NEW PEER REVIEW LAW QUESTIONS & ANSWERS

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PEER REVIEW Q &A

- **Q:** My firm only does compilations. Does that mean I have to get a peer review?

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PEER REVIEW Q &A

- **A:** No. Included in the state's definition of attest are audits, financial statement reviews and examinations. Compilations are not considered attest services. However, even if a firm has only one client for which it provides any type of aforementioned attest service, the firm would be obligated under state law to undergo a peer review once the bill is

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PEER REVIEW Q & A

- **Q:** How much is this going to cost?

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PEER REVIEW Q & A

- **A:** Costs include an annual administrative fee and a fee for the review itself in the year it is performed. The annual administrative fee is levied on Peer Review Program (PRP) enrollees to cover the costs of PRP administration, which includes the administrative and technical review of peer reviews, required program oversight procedures, and reviewer résumé and CPE verification. For more information and a formula that will help you to determine your annual administrative fee, go to [this page](#).

For the peer review, the cost varies according to firm size, the number of attest clients and the types of engagements a firm may have.

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PEER REVIEW Q & A

- **Q:** Why is the NYSSCPA supporting this bill?

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PEER REVIEW Q & A

- **A:** Attest service engagements come with the highest level of risk that you can provide as a CPA. Not having *at least* a peer review is a recipe for audit failure. It's not good for your business, it's not good for your client and it's not good for the profession. The New York State Quality Review Oversight Committee, a state board, which is charged with overseeing peer reviews, has recommended for a number of years that the NYSED remove the small firm exemption in the law. Mandatory peer review ensures adequate quality control and fosters best practices among the CPA firms that perform audits. New York state is the only state in the country that does not mandate peer review of attest services for all firms that provide them. This bill seeks to ensure that all CPA firms with attest practices are subject to peer review.

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WHAT IS A PEER REVIEW?

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PEER REVIEW BASICS

- AICPA program administered by the states
- Monitors a CPA firm's A&A practice
- Goal - promote quality in A&A services
- Evaluates a firm's quality control and ability to issue reports in compliance with professional standards

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QUALITY CONTROL SYSTEM

- All firms required to have a documented QC system
- System is composed of elements:
 - Leadership responsibilities
 - Relevant ethical requirements
 - Human resources
 - Acceptance and continuance of client relationships and specific engagements
 - Engagement performance
 - Monitoring

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MONITORING

- Required for all size firms
- Covers all QC elements
- Engagement inspections
 - More than just a normal review
 - May not required in peer review year
 - Cover risky industries

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TYPES OF PEER REVIEW

- System
 - Evaluates the system of quality control & ability of QC system to ensure compliance
 - Required if audits performed
 - More expensive but more forgiving
- Engagement
 - Evaluates compliance with standards on specific engagements
 - Required if audits performed
 - Allowed if A&A practice is only compilations & reviews
 - Cheaper but less forgiving

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PEER REVIEW TIMELINE

- Reviews are required every 3 years
- Covers a one year period
- Peer review reports due 6 months from PR YE date

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PEER REVIEW RESULTS

- Types of Reports:
 - Pass
 - Pass with Deficiencies
 - Fail
- Types of Findings
 - Matter for Further Consideration
 - Finding for Further Consideration
 - Deficiency
 - Significant Deficiency

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PEER REVIEW

Enhancing Audit Quality Initiative

What has the AICPA been doing?

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PEER REVIEW

- Peer Review: Where We've Been
- Update on EAQ Initiatives
- Latest Developments In Peer Review
- Non-conforming Engagements

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PEER REVIEW

Goal: Enhanced Quality

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PEER REVIEW

Moving the Quality Needle

- Yesterday
 - Implement reforms
- Today
 - Remediate firms
- Tomorrow
 - Enhanced quality

Quality

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PEER REVIEW

Peer Review : Where We've Been

269

Peer Review Enhanced Oversight Program

- Objectives
 - Focus on must-select engagements.
 - Identify material departures from professional standards.
 - Evaluate the performance of reviewers.
 - Provide education and feedback to peer reviewers and firms.

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Peer Review Enhanced Oversight Program

- Enhanced Oversight Program: Year one (2014)

43%

Of engagements were non-conforming

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Detection of Non-Conformity is Improving

Percentage of non-conforming engagements detected by Peer Reviewers

- 2014 22%
- 2015 55%
- 2016-2017 56%*
- 2018 68% **

* Switched to calendar-year cycle

** Results are not yet Final

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Progress through Remediation

- 77% Improvement after continuing professional education
- 86% Improvement after third-party review of engagements or QC documents
- 90% Improvement after pre-issuance review of firm engagements

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Firms Performing Specialized Engagements

- 2014
 - EBP 6,700
 - Single Audit 4,900
- 2015
 - EBP 6,250
 - Single Audit 4,750
- 2016
 - EBP 5,750
 - Single Audit 4,350
- 2017
 - EBP 5,500
 - Single Audit 4,250

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Update on EAQ Initiatives: 2019 Areas of Focus

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2019 EAQ Areas of Focus

- Risk Assessment
- Documentation
- Auditing estimates
(including fair value and revenue recognition)
- Internal Control
- SOC Reports (including cyber and vendor supply chain)

276

Update on EAQ initiatives: Risk Assessment

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Risk Assessment: What we Found

More than **47% of firms** are not conforming with AU-C section 315 and AU-C section 330

Common issues include:

- Limited or non-existent risk assessment
- No linkage between assessed risks and planned responses
- Improper use of third-party practice aids

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Risk Assessment: What We Can Do

Use the tools found at aicpa.org/riskassessment

- Audit risk assessment tool (with videos)
- Staff training
- Internal inspection aid
- Aid for identifying and testing controls at smaller entities and entities in specific industries

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Update on EAQ Initiatives: Documentation

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Documentation: What We Found

Common misconceptions:

- Auditors can meet overall audit objectives without documenting their work
- A signoff on an audit program is sufficient documentation of a detail test
- Oral explanation can substitute for written documentation to meet the requirements of the standards

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Documentation: What We've Done

- Free tools at aicpa.org/documentation
- Quiz at journalofaccountancy.com/documentation
- Targeted communications and education

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Documentation: What You Can Do

- Use the tools found at aicpa.org/documentation

Stress the importance of documentation when

- Reviewing engagements
- Performing Engagement Quality Control Reviews (EQCRs)
- Conducting internal inspections

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Update on EAQ Initiatives: Auditing Estimates

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Auditing Estimates Misconceptions

- The expectation is that many firms will need assistance with the new revenue recognition standard
- There are free resources at aicpa.org/revenue-recognition, including:
 - New Revenue Recognition Accounting Standard Learning and Implementation Plan Roadmap
 - Financial Reporting Brief: Roadmap to Understanding the New Revenue Recognition Standards
 - A&A Guides ,webcasts, and much more

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Update on EAQ Initiatives: Internal Control

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Auditor Responsibilities for Internal Controls

- Identify internal controls
- Identify internal controls relevant to the audit
- Evaluate controls and determine if implemented
- Assess control risk

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Internal Control Missteps

- Assuming the client has no controls
- Not understanding which controls are relevant to the audit
- Stopping after determining whether controls exist
- Improperly assessing control risk
- Failing to link further procedures to control-related risks
- Free toolkit: aicpa.org/internalcontrol

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Update on EAQ Initiatives: SOC Reports

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SOC Report Misses

- Awareness of Engagement Team
 - Some were applying outdated standards
- Documentation
 - Issues across the board: from risk assessment and suitability of criteria to materiality considerations and nature, timing, and extent of procedures
- Reports
 - Several did not include all required elements
- Resources: aicpa.org/soc

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Update on EAQ Initiatives: 2020 Areas of Focus

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2020 EAQ Areas of Focus

- Engagement acceptance/independence
- Risk assessment
- Auditing estimates
- Internal control
- SOC reports

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Update on Non-Conforming Engagements

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Risk Assessment: New Guidance

- Non-compliance should equal **non-conforming!**
- Systemic evaluation:

Isolated?	Evaluation
Yes	MFC
No, and only risk assessment matters/deficiency exist	FFC with required implementation plan
No, but additional deficiencies (other than risk assessment) exist	Deficiency/significant deficiency with corrective action

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Causes of Non-conformity

- Inadequate of nonexistent audit documentation (>50% of non-conforming engagements)
- Single Audits
 - No testing of internal controls over compliance (23%)
 - No testing of one or more applicable compliance requirements (16%)
- Employee Benefit Plans
 - No evidence of SOC 1 report evaluation (20%)

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CHANGE THE PROCESS

- Firms required to have a QC document
 - <http://www.aicpa.org/interestareas/frc/pages/enhancingauditqualitypracticeaid.aspx>
- Assist in determination of systemic causes
- Response to findings must include
 - Actions taken or planned to remediate
 - Timing of remediation

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IMPROVE TRACKING

- Uncovered information on
 - Firms that aren't enrolled
 - Firms that have engagement reviews
 - Firms that perform must-select engagements
- Goal is to effectively and efficiently match records
- Working with information providers and regulators

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MAKE RESULTS MORE INFORMATIVE

- Peer review reports more organized & informative
 - Deficiencies reference SQCS requirement
 - Non-conforming engagements identified
- Feedback from users
 - Like the three ratings
 - Want firm demographics
 - Additional details on engagements in regulated industries or high risk areas

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NEW PRIMA SYSTEM

- PRIMA (Peer Review Integrated Management Application) replaces PRISM (Peer Review Information System Manager)
- Effective May 1, 2017
- Firms required to access PRIMA
 - Update Enrollment & schedule peer review
 - Respond to MFCs & FFCs
 - Acknowledge peer review acceptance letter
 - Submit evidence for corrective actions

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PICPA

What's happening at
PICPA?

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ADMINISTRATING ENTITY

- NYSSCPA board vote in March 2017
- 2017-2018 transition phase
- Administration officially transferred to Pennsylvania Institute of CPAs on March 15, 2018
- *Firms will have ability to choose administering entity*

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PEER REVIEW PREPARATION

WHAT SHOULD I
DO?

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SUGGESTIONS

- Read SQCS 8
- Develop a QC Document
- Determine what level of review you need
- If it's your first time peer review or you had a bad prior peer review, get EXTERNAL qualified help to see where your holes are
- Register for PRIMA

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SUGGESTIONS

- Ensure your peer review year end makes sense
- Don't wait to line up peer reviewer
- Reviewer's background has to match firm's profile
- Schedule review a minimum of one month prior to due date
- Identify a point person within your firm
 - Familiar with firm's QC system & engagements
 - Available to reviewer before, during & after the review

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REMINDERS

- You must have an EQCR policy
- Make sure monitoring is done and documented
- Check licenses and CPE
- Engagement list:
 - Must include ALL engagements, even those not performed or completed yet
 - Identify type & industry
 - How did you determine completeness?

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REMINDERS

- Independence is a Big Deal
- Independence confirms are required for everyone
- Financial statement preparation is a NON-ATTEST SERVICE
- Document independence considerations

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PEER REVIEW FOCUS AREAS

- Risk Assessment
- Independence
- Sufficiency of Audit Evidence
- Employee Benefit Plans
- Issuers of Municipal Securities
- Single Audit (Uniform Guidance Changes)
- Crowdfunding

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OVERARCHING PRINCIPLE

**IF IT WASN'T
DOCUMENTED IT
WASN'T DONE**

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PEER REVIEW

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