

2022

**Wiley**  
**PRACTITIONER'S GUIDE TO**  
**GAAAS**

Covering All SASs, SSAEs, SSARs,  
and Interpretations

Joanne M. Flood

With complete,  
in-depth coverage  
of all the professional  
standards and valuable  
checklists and  
graphic aids

**WILEY**



**WILEY**

---

**Practitioner's Guide to**

**GAAS**  
**2022**



## Subscriber Update Service

### **BECOME A SUBSCRIBER!**

*Did you purchase this product from a bookstore?*

If you did, it's important for you to become a subscriber. John Wiley & Sons, Inc. may publish, on a periodic basis, supplements and new editions to reflect the latest changes in the subject matter that you ***need to know*** in order to stay competitive in this ever-changing industry. By contacting the Wiley office nearest you, you'll receive any current update at no additional charge. In addition, you'll receive future updates and revised or related volumes on a 30-day examination review.

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

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

mailing address:

**Supplement Department  
John Wiley & Sons, Inc.  
9200 Keystone Crossing, Suite 800  
Indianapolis, IN 46240**

e-mail:

[subscriber@wiley.com](mailto:subscriber@wiley.com)

fax:

1-800-605-2665

online:

[www.wiley.com](http://www.wiley.com)

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

Professional & Reference Division  
John Wiley & Sons Canada, Ltd.  
90 Eglinton Ave. E, Suite 300  
Toronto, Ontario M4P 2Y3  
CANADA  
Phone: 416-236-4433  
Phone: 1-800-567-4797  
Fax: 416-236-8743  
Email: [canada@wiley.com](mailto:canada@wiley.com)

John Wiley & Sons Australia, Ltd.  
42 McDougall Street  
Milton, Queensland 4064  
AUSTRALIA  
Phone: 61-7-3859-9755  
Fax: 61-7-3859-9715  
Email: [aus-custservice@wiley.com](mailto:aus-custservice@wiley.com)

John Wiley & Sons, Ltd.  
European Distribution Centre  
New Era Estate  
Oldlands Way  
Bognor Regis, West Sussex  
PO22 9NQ, UK  
Phone: (0)1243 779777  
Fax: (0)1243 843 123  
Email: [customer@wiley.co.uk](mailto:customer@wiley.co.uk)

John Wiley & Sons (Asia) Pte., Ltd.  
1 Fusionopolis Walk  
#07-01 Solaris South Tower  
SINGAPORE 138628  
Phone: 65-6302-9838  
Fax: 65-6265-1782  
Customer Service: 65-6302-9800  
Email: [asiacart@wiley.com](mailto:asiacart@wiley.com)

**WILEY**

---

**Practitioner's Guide to**  
**GAAS**  
**2022**

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

**Joanne M. Flood, MBA, CPA**

**WILEY**

Copyright © 2022 by John Wiley & Sons, Inc. All rights reserved.

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

Published simultaneously in Canada.

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

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

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

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

***Library of Congress Cataloging-in-Publication Data is Available:***

ISBN 9781119875017 (Paperback)

ISBN 9781119875024 (ePDF)

ISBN 9781119875048 (ePub)

Cover Design and Image: Wiley

# CONTENTS

---

	<b>Preface</b>	<b>ix</b>
	<b>About the Author</b>	<b>xi</b>
<b>1 AU-C 200</b>	Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Generally Accepted Auditing Standards	<b>1</b>
<b>2 AU-C 210</b>	Terms of Engagement	<b>7</b>
<b>3 AU-C 220</b>	Quality Control for an Engagement Conducted in Accordance with Generally Accepted Auditing Standards	<b>15</b>
<b>4 AU-C 230</b>	Audit Documentation	<b>23</b>
<b>5 AU-C 240</b>	Consideration of Fraud in a Financial Statement Audit	<b>35</b>
<b>6 AU-C 250</b>	Consideration of Laws and Regulations in an Audit of Financial Statements	<b>65</b>
<b>7 AU-C 260</b>	The Auditor's Communication with Those Charged with Governance	<b>71</b>
<b>8 AU-C 265</b>	Communicating Internal Control Related Matters Identified in an Audit	<b>79</b>
<b>9 AU-C 300</b>	Planning an Audit	<b>89</b>
<b>10 AU-C 315</b>	Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement	<b>95</b>
<b>11 AU-C 320</b>	Materiality in Planning and Performing an Audit	<b>125</b>
<b>12 AU-C 330</b>	Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained	<b>131</b>
<b>13 AU-C 402</b>	Audit Considerations Relating to an Entity Using a Service Organization	<b>161</b>
<b>14 AU-C 450</b>	Evaluation of Misstatements Identified during the Audit	<b>169</b>
<b>15 AU-C 500</b>	Audit Evidence	<b>175</b>
<b>16 AU-C 501</b>	Audit Evidence—Specific Considerations for Selected Items	<b>181</b>
<b>17 AU-C 505</b>	External Confirmations	<b>217</b>
<b>18 AU-C 510</b>	Opening Balances—Initial Audit Engagements, Including Reaudit Engagements	<b>233</b>
<b>19 AU-C 520</b>	Analytical Procedures	<b>241</b>
<b>20 AU-C 530</b>	Audit Sampling	<b>255</b>

<b>21 AU-C 540</b>	Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures	<b>281</b>
<b>22 AU-C 550</b>	Related Parties	<b>295</b>
<b>23 AU-C 560</b>	Subsequent Events and Subsequently Discovered Facts	<b>309</b>
<b>24 AU-C 570</b>	The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern	<b>323</b>
<b>25 AU-C 580</b>	Written Representations	<b>339</b>
<b>26 AU-C 585</b>	Consideration of Omitted Procedures after the Report Release Date	<b>353</b>
<b>27 AU-C 600</b>	Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)	<b>359</b>
<b>28 AU-C 610</b>	Using the Work of Internal Auditors	<b>383</b>
<b>29 AU-C 620</b>	Using the Work of an Auditor's Specialist	<b>397</b>
<b>30 AU-C 700</b>	Forming an Opinion and Reporting on Financial Statements	<b>407</b>
<b>31 AU-C 701</b>	Communicating Key Audit Matters in the Independent Auditor's Report	<b>433</b>
<b>32 AU-C 703</b>	Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA	<b>441</b>
<b>33 AU-C 705</b>	Modifications to the Opinion in the Independent Auditor's Report	<b>477</b>
<b>34 AU-C 706</b>	Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report	<b>501</b>
<b>35 AU-C 708</b>	Consistency of Financial Statements	<b>515</b>
<b>36 AU-C 720</b>	Other Information in Documents Containing Audited Financial Statements	<b>519</b>
<b>37 AU-C 725</b>	Supplementary Information in Relation to the Financial Statements as a Whole	<b>525</b>
<b>38 AU-C 730</b>	Required Supplementary Information	<b>533</b>
<b>39 AU-C 800</b>	Special Considerations—Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks	<b>539</b>
<b>40 AU-C 805</b>	Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement	<b>553</b>
<b>41 AU-C 806</b>	Reporting on Compliance with Aspects of Contractual Agreements or Regulatory Requirements in Connection with Audited Financial Statements	<b>567</b>
<b>42 AU-C 810</b>	Engagements to Report on Summary Financial Statements	<b>575</b>



<b>43 AU-C 905</b>	<b>Alert That Restricts the Use of the Auditor’s Written Communication</b>	<b>585</b>
<b>44 AU-C 910</b>	<b>Financial Statements Prepared in Accordance with a Financial Reporting Framework Generally Accepted in Another Country</b>	<b>593</b>
<b>45 AU-C 915</b>	<b>Reports on Application of Requirements of an Applicable Financial Reporting Framework</b>	<b>599</b>
<b>46 AU-C 920</b>	<b>Letters for Underwriters and Certain Other Requesting Parties</b>	<b>605</b>
<b>47 AU-C 925</b>	<b>Filings with the U.S. Securities and Exchange Commission under the Securities Act of 1933</b>	<b>643</b>
<b>48 AU-C 930</b>	<b>Interim Financial Information</b>	<b>649</b>
<b>49 AU-C 935</b>	<b>Compliance Audits</b>	<b>677</b>
<b>50 AU-C 940</b>	<b>An Audit of Internal Control over Financial Reporting That Is Integrated with an Audit of Financial Statements</b>	<b>687</b>
<b>51 AU-C 945</b>	<b>Auditor Involvement with Exempt Offering Documents</b>	<b>713</b>
<b>52 AT-C</b>	<b>Preface</b>	<b>717</b>
<b>53 AT-C 105</b>	<b>Concepts Common to All Attestation Engagements</b>	<b>721</b>
<b>54 AT-C 205</b>	<b>Assertion-Based Examination Engagements</b>	<b>737</b>
<b>55 AT-C 206</b>	<b>Direct Examination Engagements</b>	<b>761</b>
<b>56 AT-C 210</b>	<b>Review Engagements</b>	<b>771</b>
<b>57 AT-C 215</b>	<b>Agreed-Upon Procedures Engagements</b>	<b>789</b>
<b>58 AT-C 305</b>	<b>Prospective Financial Information</b>	<b>807</b>
<b>59 AT-C 310</b>	<b>Reporting on Pro Forma Financial Information</b>	<b>821</b>
<b>60 AT-C 315</b>	<b>Compliance Attestation</b>	<b>835</b>
<b>61 AT-C 320</b>	<b>Reporting on an Examination of Controls at a Service Organization Relevant to User Entities’ Internal Control Over Financial Reporting</b>	<b>845</b>
<b>62 AT-C 395</b>	<b>Management’s Discussion and Analysis</b>	<b>861</b>
<b>63 AR-C 60</b>	<b>General Principles for Engagements Performed in Accordance with Statements on Standards for Accounting and Review Services</b>	<b>869</b>
<b>64 AR-C 70</b>	<b>Preparation of Financial Statements</b>	<b>875</b>
<b>65 AR-C 80</b>	<b>Compilation Engagements</b>	<b>883</b>
<b>66 AR-C 90</b>	<b>Review of Financial Statements</b>	<b>905</b>
<b>67 AR-C 100</b>	<b>Special Considerations—International Reporting Issues</b>	<b>947</b>
<b>68 AR-C 120</b>	<b>Compilation of Pro Forma Financial Information</b>	<b>957</b>

<b>Appendix A</b>	Definitions of Terms—AU-C Standards	<b>963</b>
<b>Appendix B</b>	Definitions of Terms—AT-C Standards	<b>983</b>
<b>Appendix C</b>	Definitions of Terms—AR-C Standards	<b>993</b>
<b>Appendix D</b>	Interpretive Publications and Other Auditing Publications	<b>999</b>
<b>Index</b>		<b>1001</b>

# PREFACE—ORGANIZATION AND KEY CHANGES

---

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

## RESOURCES

---

*Wiley Practitioner's Guide to GAAS 2022* contains robust tools to help practitioners implement the standards. This book follows the sequence of sections of the AICPA Codification of Statements on Auditing Standards, the Codification of Statements on Standards for Attestation Engagements, and the Codification of Statements on Standards for Accounting and Review Services. Sections are divided into the following easy-to-understand parts:

**Scope.** A handy brief identification of the original standard for the section.

**Definitions of Terms.** A list of official definitions that refers readers to one of the appendices to find explanations of terms that are ordinarily scattered throughout the standards.

**Objectives.** An explanation of the reasons for the section.

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

**Interpretations.** A brief summary of each interpretation.

**Illustrations.** Sample reports and checklists.

## NEW AUDITING STANDARDS

### Audit Evidence—SAS 142

In July 2020, the ASB issued SAS 142, *Audit Evidence*. The SAS is intended to provide auditors with enhanced guidance on audit evidence by:

- Providing risk assessment requirements for estimates and
- Further procedures that:
  - are more specific to estimates,
  - address today's complex business environment and the complexity of financial reporting frameworks,
  - highlight the causes of uncertainty, and
  - focus on the risk of management bias.

The SAS supersedes AU-C 500 and amends other Sections. SAS 142 is effective for periods ending on or after December 15, 2022.

**Auditing Accounting Estimates and Related Disclosures—SAS 143**

SAS 143 enables auditors to appropriately address complex scenarios from accounting standards that include estimates and related disclosures and to enhance the auditor's focus on factors that drive estimation uncertainty and management biases. Particularly important are estimates related to asset impairments during the current environment of economic uncertainty and volatility.

SAS 143 is effective for audits of financial statements for periods ending on or after December 15, 2023.

**ATTESTATION STANDARDS**

---

The ASB has a project to develop a guide for an examination engagement on internal controls, other than an audit of ICFR that is integrated with a financial statement audit.

**ACCOUNTING AND REVIEW STANDARDS**

---

In February 2020 the ARSC issued SSARS 25, *Materiality in a Review of Financial Statements and Adverse Conclusions*. SSARS 25 amends AR-Cs 60, 70, 80, and 90. The SSARS converges AR-C 90 with Substantial Standard for Review Engagements 2400. SSARS 25 also aligns concepts of materiality with auditing standards.

SSARS 25 is effective for engagements performed in accordance with SSARSs on financial statements for periods ending on or after December 15, 2021.

**PUBLICATION CURRENCY**

---

This publication is current through SAS No. 143, SSARS 25, and SSAE 19.

Joanne M. Flood  
September 2022

## ABOUT THE AUTHOR

---

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

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

*Financial Disclosure Checklist*

*Wiley GAAP 2022: Interpretation and Application of Generally Accepted Accounting Principles*

*Wiley Practitioner's Guide to GAAS 2022: Covering All SASs, SSAEs, SSARSs, and Interpretations*

*Wiley GAAP: Financial Statement Disclosures Manual (Wiley Regulatory Reporting)*

*Wiley Revenue Recognition*



# 1

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

Scope	1	Materiality	2
Definitions of Terms	1	Ethical Requirements	3
Objectives of AU-C Section 200	2	Professional Judgment and Skepticism	4
Requirements	2	<b>Complying with GAAS</b>	<b>5</b>
Management's Responsibilities	2	GAAS and the GAAS Hierarchy	5
Auditor's Objectives	2		

### SCOPE

---

AU-C 200 describes:

- The auditor's overall responsibilities when conducting a GAAS audit, including
  - The auditor's overall objectives,
  - The nature and scope of the audit, and
  - The scope, authority, and structure of GAAS.

(AU-C 200.01)

### DEFINITIONS OF TERMS

---

**Source: AU-C 200.14.** For definitions related to this standard, see Appendix A, "Definitions of Terms": Applicable financial reporting framework, Audit evidence, Audit risk, Auditor, Detection risk, Financial reporting framework, Financial statements, Historical financial information, Interpretive publications, Management, Misstatement, Other auditing publications, Premise, relating to the responsibilities of management and, when appropriate, those charged with governance, on which an audit is conducted (the premise), Professional judgment, Professional skepticism, Reasonable assurance, Risk of material misstatement, Those charged with governance.

## OBJECTIVES OF AU-C SECTION 200

---

The overall objectives of the auditor, in conducting an audit of financial statements, are to:

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

(AU-C 200.12)

If reasonable assurance cannot be obtained and a qualified opinion is insufficient, the auditor must either:

- Disclaim an opinion or
- Withdraw from the engagement when possible under applicable law or regulation.

(AU-C 200.13)

## REQUIREMENTS

---

### MANAGEMENT'S RESPONSIBILITIES

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

Many times clients do not understand their responsibilities for audited financial statements. The financial statements are *management's*. They contain management's representations. The form and content of the financial statements are management's responsibility, even if the auditor prepared them or participated in their preparation. Management also is responsible for implementing and maintaining an effective system of internal control. (See Appendix A, definition of premise.)

### AUDITOR'S OBJECTIVES

The purpose of an audit of financial statements is confined to the expression of an opinion on the financial statements being audited. In performing the audit, the auditor is responsible for compliance with GAAS. (AU-C 200.04)

### MATERIALITY

In every audit, the auditor has to obtain reasonable assurance<sup>1</sup> about whether the financial statements are free of material misstatement, whether due to errors or to fraud. (AU-C 200.06) Materiality is taken into account when planning and performing the audit.

---

<sup>1</sup> See Appendix A, *Definitions of Terms*.



Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.<sup>2</sup> However, the auditor is not required to obtain reasonable assurance that misstatements not material to the financial statements taken as a whole, whether caused by fraud or error, are detected. Materiality considers qualitative and quantitative elements and should be viewed in context. (AU-C 200.07)

## ETHICAL REQUIREMENTS

The auditor has a responsibility to consider GAAS in all audits. For more information, see the section “Complying with GAAS” later in this chapter.

To provide reasonable assurance that it is conforming with generally accepted auditing standards in its audit engagements, an accounting firm should establish quality control policies and procedures. These policies and procedures should apply not only to audit engagements but also to attest any accounting and review services for which professional standards have been established. (AU-C 200.A20) The AICPA’s Quality Control Standards detail the firm’s responsibility for establishing and maintaining a system of quality control for auditors. See QC Section 10, *A Firm’s System of Quality Control*, for more information.

The auditor must be independent. If not independent, the auditor cannot issue a report under GAAS. The only exception is if GAAS provides otherwise or law or regulation requires the auditor to accept the engagement and report on the financial statements. (AU-C 200.15) In that situation, AU-C 705, *Modifications to the Opinion in the Independent Auditor’s Report*, applies.

To be *independent*, the auditor must be intellectually honest; to be *recognized* as independent, he or she must be free from any obligation to or interest in the client, its management, or its owners. The auditor should be independent in appearance as well as fact. (AU-C 200.A17) For specific guidance, the auditor should look to the AICPA and the state society codes of conduct and, if relevant, the requirements of the Securities and Exchange Commission (SEC). (AU-C 210.A21)

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

1. Independence is an impartiality that recognizes an obligation for fairness.
2. Integrity pertains to being honest and candid, and requires that service and public trust not be subordinated to personal gain.
3. Objectivity is a state of mind that imposes an obligation to be impartial, intellectually honest, and free of conflicts of interest.
4. Due care requires the auditor to discharge professional responsibilities with the competence and diligence necessary to perform the audit and issue an appropriate report and to render services promptly, thoroughly, and carefully, while observing applicable standards. (AU-C 200.A19)

(AU-C 200.A16)

(See the AICPA’s Code of Professional Conduct, ET.0.300.)

---

<sup>2</sup> This definition of materiality from SAS No. 138 aligns the GAAS description with that of the IASB and the IAASB. It aligns materiality concepts in AICPA Professional Standards with the description used by the U.S. judicial system, the PCAOB, the SEC, and the FASB. SAS 138 is effective for periods ending on or after December 15, 2021.

## PROFESSIONAL JUDGMENT AND SKEPTICISM

### Professional Judgment

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

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

Professional judgment is developed through training and experience. It will come into play in all aspects of the audit, particularly when

- Assigning materiality,
- Assessing audit risk,
- Evaluating the sufficiency of audit evidence,
- Evaluating management's integrity and judgment, and
- Arriving at conclusions.

(AU-C 200.A28)

As can be seen from the above list, professional judgment is exercised throughout the audit.

### Professional Skepticism

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

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

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

(AU-C 200.A22–.A23)

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

Auditor's biases, whether conscious or unconscious, may affect professional skepticism and judgment. Those biases may affect the design and performance of procedures and the evaluation of audit evidence. Here are examples of some biases:

- Availability – events or experiences that come to mind or are readily available
- Confirmation – items that affirm an existing belief rather than contradict an existing belief
- Overconfidence – overestimating one's ability to make accurate risk assessments or other judgments

- Anchoring – using an initial piece of information to inadequately assess subsequent information
- Automation – favoring information generated by automated systems even when there are questions about its reliability or usefulness

(AU-C 500.A27)

### Sufficient Appropriate Audit Evidence and Audit Risk

In order to form an opinion, the auditor must obtain reasonable assurance. The auditor obtains reasonable assurance by obtaining sufficient appropriate audit evidence to reduce audit risk to an acceptably low level to draw a reasonable conclusion. (AU-C 200.19)

## COMPLYING WITH GAAS

---

Auditors must comply with and understand relevant AU-C sections; that is, those that are in effect and address the circumstances of the audit. (AU-C 200.20 and .21) GAAS uses two categories of professional requirements to describe the degree of responsibility the standards impose on auditors.

1. *Unconditional requirements.* The auditor is required to comply with an unconditional requirement in all cases in which the circumstances exist to which the unconditional requirement applies. SASs use the word *must* to indicate an unconditional requirement.
2. *Presumptively mandatory requirements.* The auditor is also required to comply with a presumptively mandatory requirement in all circumstances where the presumptively mandatory requirement exists and applies. However, in rare circumstances, the auditor may depart from a presumptively mandatory requirement. The departure should only relate to a specific procedure when the auditors determine that the procedure would be ineffective in the specific circumstances. The auditors must document their justification for the departure and how the alternative procedures performed in the circumstances were sufficient to achieve the objectives of the presumptively mandatory requirement. GAAS uses the word *should* to indicate a presumptively mandatory requirement.  
(AU-C 200.25–.26)

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

AU-C Section 200 also clarifies that explanatory material is intended to explain the objective of the professional requirements, rather than impose a professional requirement for the auditor to perform. (AU-C 200.A64)

### GAAS AND THE GAAS HIERARCHY

The auditor is responsible for planning, conducting, and reporting the results of an audit according to GAAS.<sup>3</sup> GAAS provide the standards for the auditors' work in fulfilling their objectives. Each AU-C section contains objectives that provide a link between the requirements and

---

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

the overall objectives of the auditors. Auditors should have sufficient knowledge of the AU-C sections to determine when they apply, and should be prepared to justify departures from them.

### **Interpretive Publications**

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

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

(AU-C 200.A82)

Auditors should consider interpretive publications that apply to their audits.

### **Other Auditing Publications**

Other auditing publications, listed in Appendix C of this book, are not authoritative but may help auditors to understand and apply GAAS. An auditor should evaluate such guidance to determine whether it is both (1) *relevant* for a particular engagement and (2) *appropriate* for the particular situation. When evaluating whether the guidance is appropriate, the auditor should consider whether the publication is recognized as helpful in understanding and applying SASs, and whether the author is recognized as an auditing authority. AICPA auditing publications that have been reviewed by the AICPA Audit and Attest Standards staff are presumed to be appropriate. (AU-C 200.A83–.A85)

## 2

# AU-C 210 Terms of Engagement

Scope	7	Fundamental Requirements	8
Definitions of Terms	7	Engagement Acceptance	8
Objectives of AU-C Section 210	7	AU-C 210 Illustration	12

## SCOPE

---

This section states the requirements and provides application guidance on the auditor’s responsibilities when agreeing upon terms of engagement with management and those charged with governance. It also establishes the important preconditions for an audit, for which management is responsible. Engagement letters can also be the foundation of a defense in the event of a dispute with the client. AU-C 220, *Quality Control for an Engagement Conducted in Accordance with Generally Accepted Auditing Standards*, addresses those aspects of engagement acceptance that the auditor can control and the auditor’s responsibilities regarding ethical requirements concerning acceptance of an engagement. (AU-C 210.01 and .A1)

## DEFINITIONS OF TERMS

---

**Source: AU-C 210.04.** For definitions related to this standard, see Appendix A, “Definitions of Terms”: Preconditions for an audit, Recurring audit.

## OBJECTIVES OF AU-C SECTION 210

---

AU-C Section 210.03 states that:

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

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

## FUNDAMENTAL REQUIREMENTS

---

### ENGAGEMENT ACCEPTANCE

#### Preconditions

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

- a. determine whether the financial reporting framework<sup>1</sup> *to be applied in the preparation of the financial statements is acceptable and*
  - b. *obtain the agreement of management that it acknowledges and understands its responsibility*
    - i. *for the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework;*
    - ii. *for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; and*
    - iii. *to provide the auditor with*
      1. *access to all information of which management is aware that is relevant to the preparation and fair presentation of the financial statements, such as records, documentation, and other matters;*
      2. *additional information that the auditor may request from management for the purpose of the audit; and*
      3. *unrestricted access to persons within the entity from whom the auditor determines it necessary to obtain audit evidence.*
- (AU-C 210.06)

In evaluating whether the financial reporting framework is acceptable, the auditor may want to consider:

- The nature of the entity
  - The purpose and nature of the financial statements
  - Whether the framework is determined by law or regulator
- (AU-C 210.A4)

Additional information may include other information, financial or nonfinancial, included in the entity’s financial report described in AU-C 720. Examples of this other information include reports on operations, financial summaries, selected quarterly data, and more. If the auditor expects to receive such information after the date of the auditor’s report, the auditor may consider including in the engagement letter actions the auditor will take if the other information contains an uncorrected material misstatement. (AU-C 210.A17)

---

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

## Limitation of Scope

If management limits the scope of the auditor's work so that the auditor will have to disclaim an opinion, the auditor should not accept the engagement. The exception to this is when management is required by law or regulation to have an audit and the disclaimer of opinion is acceptable under law or regulation, for example, with audits of employee benefit plans. Then the auditor may accept the engagement, but is not required to do so. (AU-C 210.07 and .A19)

## Agreement on Terms

The auditor should establish an understanding in writing with management or those charged with governance<sup>2</sup> about the services to be performed for each audit, review of a public company's financial statements, or agreed-upon procedures for engagement. (AU-C 210.09) The understanding should include:

1. The engagement's objectives and scope
  2. Management's responsibilities
  3. Auditor's responsibilities
  4. The audit's limitations, the inherent limitations of internal control, and the risk that some misstatements may not be detected
  5. Financial reporting framework
  6. Expected form and content of the report
- (AU-C 210.10)

In addition, the auditor may want to:

- Elaborate on the scope of the audit by referencing regulations, laws, GAAS, ethical codes, and pronouncements of professional bodies, as applicable.
  - The communication of key audit matters.
  - Identify any other communications in addition to the auditor's report.
  - Discuss audit planning and performance, including composition of the audit team.
  - Remind management to provide access to all information relevant to the preparation and fair presentation of the financial statements, including information relevant to disclosures.
  - Remind management about the expectation of written representation, the agreement to make available draft financial statements on a timely basis, including information relevant to the preparation and fair presentation of the financial statements whether obtained from within or outside of the general and subsidiary ledgers.
  - Remind management about the agreement for management to inform the auditor of subsequent events or facts discovered after the date of the financial statements that may affect the financial statements.
  - Detail fees and billing arrangements.
  - Request management to acknowledge receipt of the engagement letter and to agree to the terms by signing the letter.
- (AU-C 210.A24)

---

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

GAAS does not require auditors to communicate key audit matters. If, however, the engagement letter indicates that the auditor will do so and later it is decided not to do so, the letter should be modified. The reverse is also true. If, after the engagement letter is signed, management requests that key audit matters be communicated, the auditor should consider issuing a new engagement letter or an addendum to the assigned letter. (AU-C 210.A25)

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

If the auditor fails to establish an understanding, the auditor should decline the engagement. (AU-C 210.08) A sample engagement letter is included at the end of this chapter.

### **Initial Audits, Including Reaudits**

Inquiry of the predecessor auditor is critical because the predecessor may provide information that will assist the successor auditor in deciding whether to accept the engagement. The communication may be either written or oral. (AU-C 210.A33) Both the predecessor and successor auditors should treat any information obtained from each other as confidential information. (AU-C 210.A31) The successor auditor should request permission from the prospective client to make an inquiry of the predecessor *prior to final acceptance of the engagement*. However, the successor auditor may make a proposal for an audit engagement before having permission to inquire of the predecessor auditor.

The successor auditor should ask the prospective client to authorize the predecessor to respond fully to the successor auditor's inquiries. If a prospective client refuses to permit the predecessor auditor to respond or limits the response, the successor auditor should inquire as to the reasons and consider the implications of that refusal in deciding whether to accept the engagement. (AU-C 210.11) The successor auditor should make specific and reasonable inquiries of the predecessor about the following five matters:

1. Information about management's integrity
  2. Disagreements with management about accounting principles, auditing procedures, or other significant matters
  3. Communications to those charged with governance and responsibility regarding fraud, noncompliance with laws or regulations, and significant deficiencies and material weaknesses in internal control
  4. The predecessor auditor's understanding of the reasons for the change of auditors
  5. The predecessor auditor's understanding of the nature of the entity's relationships and transactions with related parties and significant unusual transactions
- (AU-C 210.A33)

The predecessor auditor should respond promptly, fully, and factually. However, if the predecessor decides, due to unusual circumstances such as impending, threatened, or potential litigation; disciplinary proceedings; or other unusual circumstances, not to respond fully, he or she should indicate that the response is limited. (AU-C 210.A32) Also, if more than one auditor is considering accepting the audit, the predecessor auditor does not have to respond to inquiries until an auditor has been selected by the entity and has accepted the engagement. (AU-C 210.A30)



Any information exchanged between the predecessor and successor auditors should be considered confidential. (AU-C 210.A31)

If the successor auditor receives a limited response, that auditor should consider the implications of the limited response in deciding whether to accept the engagement. (AU-C 210.12)

### **Recurring Audits**

For a recurring audit, the auditor should evaluate whether the terms of the engagement need to be changed. The auditor should also remind the client about the existing terms of engagement. (AU-C 210.13)

Certain factors may warrant a change in the terms of engagement for a recurring engagement. For example, any indication that management misunderstands the objective and scope of the audit and changes in:

- Revised or special terms of the audit engagement
  - Senior management or ownership,
  - Legal or regulatory requirements,
  - The nature or size of the entity, or
  - The financial reporting framework or other reporting requirements.
- (AU-C 210.A35)

### **Change in Terms**

If the client requests a change in the terms, the auditor must ensure that there is a reasonable justification for the change. So, too, if prior to completion of an audit, the client requests a change to an engagement with a lower level of assurance, the auditor must be satisfied that a reasonable justification for doing so exists. (AU-C 210.14 and .15)

If the terms are changed, the auditor and management should document in writing the mutually agreed-upon change. (AU-C 210.16) If, however, the auditor concludes there is no reasonable justification for a change in terms, and management does not allow the auditor to continue the original audit, the auditor must take these three steps:

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

(AU-C 210.17)

### **Report Layout Required by Law or Regulation**

If the report prescribed by law or regulation does not align with GAAS in significant ways, the auditor must decide whether the format would mislead the users and if the report could be reworded to align with GAAS or alternatively whether the auditor could attach a separate report. If none of those remedies are available, the auditor should decline the engagement unless required by law or regulation not to perform the engagement. (AU-C 210.18)

## AU-C 210 ILLUSTRATION

---

**ILLUSTRATION 1. EXAMPLE OF AN AUDIT ENGAGEMENT LETTER  
(ADAPTED FROM AUDIT STANDARDS AU-C 210.A44)**

The following is an example of an audit engagement letter for an audit of general purpose financial statements prepared in accordance with US GAAP. This letter is intended only to be a guide that may be used in conjunction with the considerations outlined in AU-C Section 210. The letter will vary according to individual requirements and circumstances and is drafted to refer to the audit of financial statements for a single reporting period. The auditor may seek legal advice about whether a proposed letter is suitable.

<i>Auditor's letterhead</i>	Smith and Jones Certified Public Accountants October 7, 20XX
<i>Addressed to the appropriate representative of those charged with governance</i>	Brock Warner Plainsmen, Inc. 2320 Tiger Blvd. Lancaster, PA 19701
<i>The objective and scope of the audit</i>	<p>You have requested that we audit the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20XX, and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements. We are pleased to confirm our acceptance and our understanding of this audit engagement by means of this letter.</p> <p>The objectives of our audit are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with auditing standards generally accepted in the United States of America (GAAS) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.</p>

<p><i>The responsibilities of the auditor</i></p>	<p>We will conduct our audit in accordance with GAAS. As part of an audit in accordance with GAAS, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:</p> <ul style="list-style-type: none"> <li>• Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.</li> <li>• Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. However, we will communicate to you in writing concerning any significant deficiencies or material weaknesses in internal control relevant to the audit of the financial statements that we have identified during the audit.</li> <li>• Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.</li> <li>• Conclude, based on the audit evidence obtained, whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.</li> </ul> <p>Because of the inherent limitations of an audit, together with the inherent limitations of internal control, an unavoidable risk that some material misstatements may not be detected exists, even though the audit is properly planned and performed in accordance with GAAS.</p>
<p><i>The responsibilities of management and identification of the applicable financial reporting framework</i></p>	<p>Our audit will be conducted on the basis that [management and, when appropriate, those charged with governance] acknowledge and understand that they have responsibility:</p> <ol style="list-style-type: none"> <li>a. For the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America;</li> <li>b. For the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or to error; and</li> </ol>

	<p>c. To provide us with:</p> <ul style="list-style-type: none"> <li>i. Access to all information of which [management] is aware that is relevant to the preparation and fair presentation of the financial statements such as records, documentation, and other matters;</li> <li>ii. Additional information that we may request from [management] for the purpose of the audit; and</li> <li>iii. Unrestricted access to persons within the entity from whom we determine it necessary to obtain audit evidence.</li> </ul> <p>As part of our audit process, we will request from [management and, when appropriate, those charged with governance] written confirmation concerning representations made to us in connection with the audit.</p>
<i>Other relevant information:</i>	<i>Insert other information, such as fee arrangements, billings, and other specific terms, as appropriate.</i>
<i>Reporting</i>	<p><i>[Insert appropriate reference to the expected form and content of the auditor's report, including, where applicable, the reporting of other information in accordance with AU-C 700:]</i></p> <p>We will issue a written report upon completion of our audit of ABC Company's financial statements. Our report will be addressed to the board of directors of ABC Company. Circumstances may arise in which our report may differ from its expected form and content based on the results of our audit. Depending on the nature of these circumstances, it may be necessary for us to modify our opinion, add an emphasis-of-matter paragraph or other-matter paragraph to our auditor's report, or, if necessary, withdraw from the engagement.</p> <p>We also will issue a written report on <i>[insert appropriate reference to other auditors' reports expected to be issued]</i> upon completion of our audit.</p>
<i>Signed Name and Title Date</i>	<p>Please sign and return the attached copy of this letter to indicate your acknowledgment of, and agreement with, the arrangements for our audit of the financial statements including our respective responsibilities.</p> <p>Smith and Jones.</p> <p>Acknowledged and agreed on behalf of Plainsmen, Inc. by _____</p>

### 3

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

<b>Scope</b>	<b>15</b>	Independence	17
<b>Definitions of Terms</b>	<b>15</b>	Acceptance and Continuance of Client	
<b>Objective of AU-C Section 220</b>	<b>16</b>	Relationships	18
<b>Requirements</b>	<b>16</b>	Assignment of Engagement Teams	18
Quality Control Standards	16	Direction, Supervision, and Performance	18
Role of the Engagement Team	16	Engagement Performance	19
System of Quality Control	16	Documentation	21
Elements of Quality Control	17		

### **SCOPE**

---

AU-C 220 addresses:

- Specific responsibilities of the auditor regarding quality control standards for an audit of financial statements
- Responsibilities of the engagement quality control reviewer
- Supervision of an audit

Quality control is the responsibility of the audit firm. (AU-C 220.01)

### **DEFINITIONS OF TERMS**

---

**Source: AU-C 220.09.** For definitions related to this standard, see Appendix A, “Definitions of Terms”: Engagement partner, Engagement quality control review, Engagement quality control reviewer, Engagement team, Firm, Monitoring, Network, Network firm, Partner, Personnel, Professional standards, Relevant ethical requirements, Staff, Suitably qualified external person.

**OBJECTIVE OF AU-C SECTION 220**

---

AU-C Section 220.08 states that:

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

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

(AU-C Section 220.08)

**REQUIREMENTS**

---

**QUALITY CONTROL STANDARDS**

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

**ROLE OF THE ENGAGEMENT TEAM**

Engagement teams are responsible for:

- Implementing quality control procedures and
- Giving the firm information relevant to independence

(AU-C 220.04)

The engagement partner should be able to rely on the firm's quality control system unless the engagement partner determines based on circumstances it is not appropriate. (AU-C 220.05) In complying with the quality control requirements, the engagement partner may use other firm members. (AU-C 220.06)

**SYSTEM OF QUALITY CONTROL**

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

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

(QC 20.04)