

# Audit Update

December 12, 2022

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## Agenda

SAS 142

SAS 143

SAS 144

SAS 145

Quality Management Suite

SAS 147

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# SAS 142



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## SAS 142

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### **Audit Evidence**

- Issued: July 2020

### Background:

- Growing use of technology
- Evolution of auditing

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## Update

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- SAS explains what constitutes audit evidence and sets out attributes of information when evaluating information

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## Objective of Auditor

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### New Objective

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

### Old Objective

- To design and perform audit procedures that enable the auditor to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the auditor's opinion

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## Definition

### Audit Evidence

- Information used by the auditor in arriving at the conclusions on which the auditor's opinion is based. Audit evidence is information to which audit procedures have been applied and consists of information that corroborates or contradicts assertions in the financial statements.

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## Forms of Information

### Oral

- Obtained through a verbal response to an inquiry

### Visual

- Obtained through observation
  - *Includes remote observation*

### Paper

- Documentary form

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## Forms of Information Cont'd

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### Electronic

- Documents stored in electronic documentary form (scanned contract)
- Data stored in an entity's IT system or obtained electronically from an external information source

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## Sources of Information

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- Management
  - *i.e. Accounting records, internal marketing information*
- External information sources & other external parties
  - *i.e. External confirmations*
- Auditor
  - *i.e. Analysis of industry trends or automated tools and techniques*

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## More Terms

### Appropriateness

- The measure of quality of audit evidence
  - Relevant – Logical connection with or bearing upon purpose
  - Reliability – Depends on nature and source of evidence and circumstances under which it is obtained

### Sufficiency

- The measure of quantity of audit evidence

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## More Terms Cont'd

### Persuasiveness

- Related to the auditor obtaining appropriate audit evidence that is sufficient for the auditor to draw reasonable conclusions

### Quantity is not solely determinative

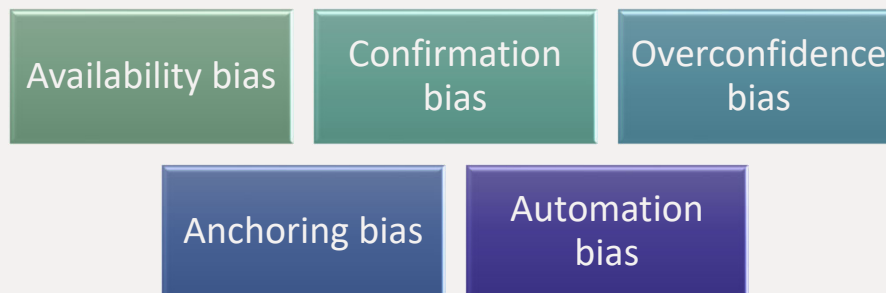
- More of the same audit evidence does not compensate for lack of appropriateness

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## Evaluation

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- Evaluating information involves maintaining professional skepticism, consideration of unconscious or conscious auditor biases



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## Evidence

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- Audit evidence is cumulative
  - The absence of information can constitute audit evidence
    - i.e. Absence of sales returns for warranty provision
- Evaluation may be enhanced by automated tools and techniques

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## Electronic Records

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- When information is transformed from its original medium, the reliability of that information depends on the controls over the information's transformation

### Audit Impact:

- Inspect underlying originals
- Test controls over the transformation and maintenance of the information

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## Data Analytics

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- The analysis of patterns, identification of anomalies, or extraction of other useful information in data underlying or related to the subject matter of an audit through analysis, modeling, or visualization
  - AI, ML, Remote Observation Tools, RPA

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## Automated Tools & Techniques

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- May be used to process, organize, structure, or present data in a given context in order to generate useful information that can be used as audit evidence

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## Audit Procedures Cont'd

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- Audit evidence is obtained through
  - Risk Assessment Procedures
  - Further Audit Procedures
    - Tests of Controls
    - Substantive Procedures
- An audit procedure may have characteristics of more than one category and can be designed to accomplish more than one objective

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## Procedures

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## Inconsistencies

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- Determine whether modifications or additions to audit procedures are necessary to resolve inconsistencies in, or doubts about the reliability of, audit evidence including when:
  - Audit evidence obtained from one source is inconsistent with information from another source
  - The results of audit procedures are inconsistent with the results of another procedure

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## Biggest Impacts

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Expands guidance on sufficient appropriate evidence

Illustrates how automated tools and techniques can be used in an audit

Incorporates professional skepticism through the standard

Moves Management's Specialist guidance to AU-C 501

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## Effective Date

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- For audits of financial statement for periods ending on or after December 15, 2022

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# SAS 143



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## SAS 143

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### **Auditing Accounting Estimates and Related Disclosures**

- Issued: July 2020

#### Background:

- Increasing use by FRF of estimates
  - Rev Rec, Leases, CECL

24

## Update

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### Objective of Auditor

- To obtain sufficient appropriate audit evidence about whether accounting estimates and related disclosures in the FS are reasonable, in the context of the applicable FRF

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## Definitions

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### Accounting Estimate

- A monetary amount for which measurement, in accordance with the requirement of the applicable FRF is subject to estimation uncertainty

### Estimation Uncertainty

- Susceptibility to an inherent lack of precision in measurement

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## Scope

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- Includes requirements and guidance that refer to or expand on the application of certain AU-C sections to accounting estimates and disclosures

AU-C 315 (Risk Assessment)

AU-C 330 (Risk Response)

AU-C 450 (Evaluating Misstatement)

AU-C 500 (Evidence)

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## Nature of Estimates

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- Accounting estimates vary widely in nature and are required to be made by management when the monetary amounts cannot be directly observed
- The measurement of these amounts is subject to estimation uncertainty due to inherent limitations in knowledge or data
  - This gives rise to inherent subjectivity and variation in measurement outcomes

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## Accounting Estimates

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- The process involves selecting and applying a method using assumptions and data, which requires judgment, and can give rise to complexity in measurement



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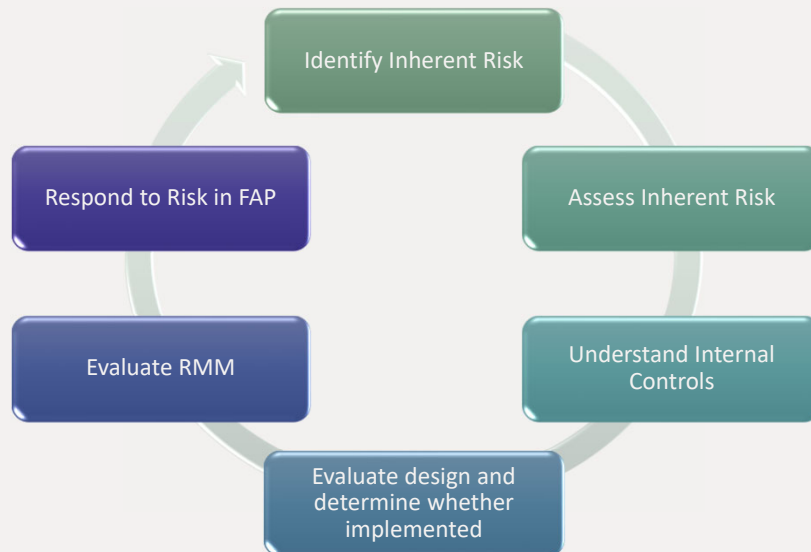
## Scalability

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- Degree of estimation uncertainty varies
  - Therefore, nature, timing and extent of risk assessment and further audit procedures will vary

30

## Risk Assessment Cont'd



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## Further Audit Procedures

- Should be responsive to assessed RMM
- Approaches:
  - Obtain audit evidence from events occurring up to the date of the auditor's report
  - Testing how management made the accounting estimate
  - Developing an auditor's point estimate or range

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## Significant Risk

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- When approach only consists of substantive procedures, should include test of details

33

## Evaluation

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- Evaluate whether the accounting estimates (and related disclosures) are reasonable in the context of the FRF or are misstated
  - Reasonable means the relevant requirements of the FRF have been applied including in
    - Development of estimate (selection of method, assumptions and data)
    - Selection of management's point estimate
    - Disclosures

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## Management Bias

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- Evaluate whether judgments and decisions, even if they are individually reasonable, indicate possible management bias

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## Documentation

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- Key elements of the auditor's understanding of the entity and its environment including internal controls related to accounting estimates
- The linkage of FAP with RMM at the relevant assertion level
- Auditor's responses when management has not taken appropriate steps to understand and address estimation uncertainty
- Indicators of possible bias and auditor's evaluation of implications for the audit

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## Effective Date

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- For audits of financial statement for periods ending on or after December 15, 2023

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SAS 144



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## SAS 144

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### **Amendments to AU-C Sections 501, 540, and 620 Related to the Use of Specialists and the Use of Pricing Information Obtained From External Information Sources**

- Issued: June 2021

#### Background:

- Responds to feedback that sought more guidance on auditing the fair value of financial instruments

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## AU-C 501

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- Amends various application material paragraphs to provide guidance on applying AU-C 540 when management has used the work of a specialist in developing accounting estimates
  - Enhance guidance about evaluating the work of the management's specialist
  - No longer refers to using the work of an external inventory-taking firm as using the work of a management's specialist

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## AU-C 540

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- New appendix, “Use of Pricing Information From Third Parties as Audit Evidence,” to provide guidance on using such information as audit evidence for estimates related to the fair value of financial instruments

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## AU-C 620

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- Adds additional paragraphs to enhance the guidance related to using the work of an auditor’s specialist

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## Effective Date

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- Effective for audits of financial statements for periods ending on or after December 15, 2023
  - Early implementation is permitted

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SAS 145



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## SAS 145

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### **Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement**

- Issued: October 2021

#### Background:

- Common Deficiency
- Convergence

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## Not Changing

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- SAS 145 does not fundamentally change the key concepts underpinning audit risk, which is a function of the risks of material misstatement and detection risk
  - Clarifies and enhances certain aspects of the identification and assessment of the risks of material misstatement to drive better risk assessments and enhance audit quality

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## Scalability

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- Complexity of an entity's activities and its environment is the primary driver of scalability
  - Removed the "Considerations Specific to Smaller Entities" sections previously included in the application material

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## Inherent Risk Factors

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- A new requirement to obtain an understanding of how inherent risk factors affect susceptibility of assertions to misstatement and the degree to which they do so, in the preparation of the financial statements in accordance with the applicable financial reporting framework

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## Inherent Risk Factors Cont'd

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- May be quantitative or qualitative
- Include
  - Complexity,
  - Subjectivity,
  - Change,
  - Uncertainty, and
  - Susceptibility to misstatement due to management bias or other fraud risk factors insofar as they affect inherent risk

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## Spectrum of Inherent Risk

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- The spectrum of inherent risk provides a frame of reference in determining the significance of the combination of the likelihood and magnitude of a misstatement

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## Significant Risks

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

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## Definitions

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- The term internal control has been changed to system of internal control, and the definition has been updated to reflect that it comprises five interrelated components

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## Entity's System of Internal Control

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- Understanding certain aspects of the entity's system of internal control is integral to the auditor's identification and assessment of the RMM, regardless of the auditor's planned controls reliance strategy
  - Clarifies that the overall understanding of the entity's system of internal control is achieved through understanding, and evaluating certain aspects of, each of the components of the system of internal control

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## Internal Control Components

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- Retains 5 components
  - Reorganizes them
  - Direct vs. Indirect Controls
    - Does not require the auditor to evaluate the design or determine the implementation of individual controls that are primarily indirect
      - Must still understand the design

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## Must Evaluate Design and Implementation

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- Control Activities
  - Controls addressing a risk that is determined to be a significant risk
  - Controls over journal entries and other adjustments as required by AU-C section 240, Consideration of Fraud in a Financial Statement Audit
  - Controls for which the auditor plans to test operating effectiveness in determining the nature, timing, and extent of substantive procedures, which include controls that address risks for which substantive procedures alone do not provide sufficient appropriate audit evidence
  - Other controls that, based on the auditor's professional judgment, the auditor considers appropriate to enable the auditor to assess RMM at the assertion level and to design further audit procedures

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## Obtaining an Understanding of the Entity

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- A new explicit requirement to understand the use of IT in the entity's structure, ownership and governance, and business model
  - Defines the IT environment, which includes IT applications and supporting IT infrastructure, as well as the IT processes and personnel involved in those processes, that an entity uses to support business operations and achieve business strategies

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## IT Controls

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- Requires the auditor to identify general IT controls that address the risks arising from the use of IT and to evaluate their design and determine their implementation
  - Often referred to as relevant controls or key controls

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## Assessing IR & CR Separately

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- Requires separate assessments of inherent risk and control risk
  - Does not prescribe a specific method for making such risk assessments nor does it require a combined assessment of inherent risk and control risk

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## CR at Maximum

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- If the auditor does not plan to test the operating effectiveness of controls, requires the auditor to assess control risk at the maximum level such that the assessment of RMM is the same as the assessment of inherent risk
  - Tests of the operating effectiveness of controls are required to support a control risk assessment below the maximum level

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## New Audit Documentation Requirements

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- Documentation of the evaluation of the design of identified controls and determination of whether such controls have been implemented
- The rationale for significant judgments made regarding the identified and assessed risks of material misstatement

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## Appendices

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- Appendix A — Considerations for Understanding the Entity and Its Business Model
- Appendix B — Understanding Inherent Risk Factors
- Appendix C — Understanding the Entity’s System of Internal Control
- Appendix D — Considerations for Understanding an Entity’s Internal Audit Function
- Appendix E — Considerations for Understanding IT
- Appendix F — Considerations for Understanding General IT Controls

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## Effective Date

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- For audits of financial statements for periods ending on or after December 15, 2023

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# Quality Management Suite



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## SQMS 1

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### **Statement on Quality Management Standards (SQMS), A Firm's System of Quality Management**

- Issued: June 2022

#### Background:

- Alignment with IAASB QM project

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## New Approach

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- Emphasizes the responsibility of firm leadership for proactively managing quality, while at the same time being scalable to deal with differences in the size of firms and nature of the services they provide
- Unlike extant QC section 10, the new approach requires a firm to customize the design, implementation, and operation of its system of quality management

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## New Approach Cont'd

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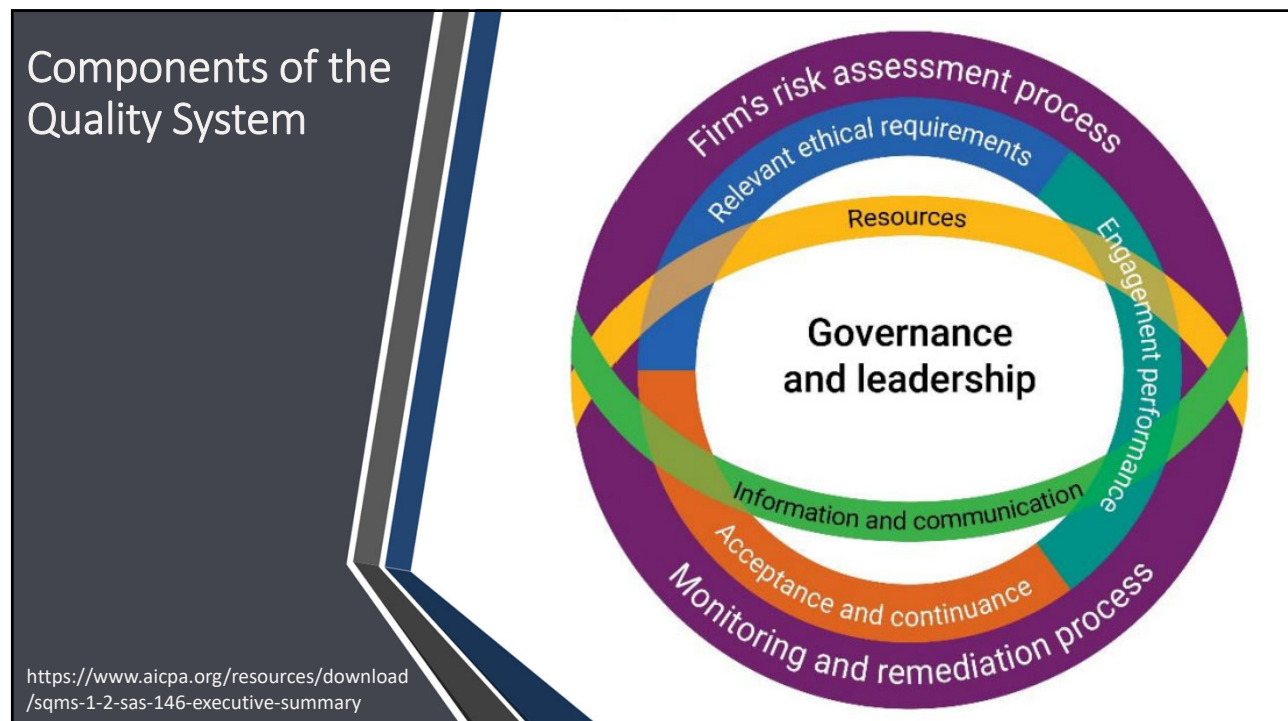
- Transitions from policies and procedures that address standalone elements to an integrated and iterative approach that reflects upon the system as a whole

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## Components of the System of QM

- The firm's risk assessment process (*new*)
- Governance and leadership (*adapted from the leadership responsibilities for quality within the firm component in QC section 10*)
- Relevant ethical requirements (*same name as component in QC section 10*)
- Acceptance and continuance of client relationships and specific engagements (*same name as component in QC section 10*)
- Engagement performance (*same name as component in QC section 10*)
- Resources (*adapted from the human resources component in QC section 10*)
- Information and communication (*new*)
- The monitoring and remediation process (*adapted from the monitoring component in QC section 10*)

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## Objective of the Firm

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- The objective of the firm is to design, implement, and operate a system of quality management for engagements performed by the firm in its accounting and auditing practice that provides the firm with reasonable assurance that
  - The firm and its personnel fulfill their responsibilities in accordance with professional standards and applicable legal and regulatory requirements and conduct engagements in accordance with such standards and requirements, and
  - Engagement reports issued by the firm are appropriate in the circumstances

## Risk Assessment Process

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- The firm's risk assessment process is a new component that comprises the process the firm is required to follow in implementing the risk-based approach to quality management

## Risk Assessment Process Cont'd

### The risk assessment process



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## Resources

- Extant QC section 10 addresses only human resources
  - SQMS No. 1 addresses all resources that the firm needs both to operate the system and to perform engagements
- These resources cover
  - Technological resources, for example, audit tools or IT applications used by the firm for independence monitoring
  - Intellectual resources, for example, the firm's methodology, guidance, templates, or tools
  - Human resources, which may include people outside the firm used in engagements and component auditors or engagement quality (EQ) reviewers external to the firm

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## Information and Communication

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- Extant QC section 10 does not address the broader need for information and communication across the system and the communication of relevant, reliable information with engagement teams
- The standard requires that the firm establish an information system with processes to identify, capture, process, and maintain information
  - Acknowledges that less complex firms with fewer personnel and direct involvement of leadership may accomplish the objective with less rigorous or detailed policies and procedures

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## Monitoring and Remediation

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- SQMS 1 more robustly addresses monitoring activities and shifts the focus from engagement level monitoring to monitoring the entire system of quality management
- The requirements promote more proactive and effective monitoring activities and have increased the emphasis on tailoring the monitoring activities to provide a sufficient basis for the firm to evaluate the system
- The new requirements are designed to emphasize factors that the firm would consider in designing its monitoring activities, rather than prescribing all the monitoring activities that need to be performed

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## Change from Proposal

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- Permits self-inspection
  - However, indicates less effective

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## Addressing Deficiencies

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- The standard includes requirements for evaluating findings and identifying deficiencies and evaluating the severity and persuasiveness of the deficiencies
  - Includes a new requirement to investigate the root cause of identified deficiencies

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## Effective Date

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- SQMS No. 1: Systems of quality management in compliance with SQMS No. 1 would be required to be designed and implemented by December 15, 2025
- The evaluation of the system of quality management required by SQMS No. 1 would be required to be performed within one year following December 15, 2025

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## SQMS2

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### **Statement on Quality Management Standards (SQMS), Engagement Quality Reviews**

- Issued: June 2022

#### Background:

- Alignment with IAASB QM project

78

## Application

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- Applies to all engagements for which an engagement quality review is required to be performed
  - Specified response designed and implemented by the firm in accordance with SQMS1
  - Continues to allow flexibility

79

## Public Interest

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- The public interest is served by the consistent performance of quality engagements

80



## Objective

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- The objective of the firm, through appointing an eligible engagement quality reviewer, is to perform an objective evaluation of the significant judgments made by the engagement team and the conclusions reached thereon

81

## Relationships

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- Engagement quality reviewer is NOT a member of the engagement team
  - Does not change responsibilities of engagement partner for achieving quality

82

## Requirements

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- Firms should establish policies or procedures that require the assignment of responsibility for the appointment of engagement quality reviewers to an individual or individuals with the competence, capabilities, and appropriate authority within the firm to fulfill the responsibility

83

## Eligibility

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- The firm should establish policies or procedures that set forth the criteria for eligibility to be appointed as an engagement quality reviewer
  - Can not be a member of the engagement team

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## Eligibility Cont'd

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- Eligibility
  - Not a member of the engagement team
  - Competence and capabilities, including sufficient time, and the appropriate authority to perform the quality review
  - Complies with the relevant ethical requirements including objectivity and independence
  - Complies with laws and regulations

85

## Performance

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- Read, and obtain an understanding about nature and circumstances of the engagement and the entity
- Discuss significant matters and judgments in planning, performing and reporting
- Review selected engagement documentation related to significant judgments
- Evaluate requirements related to independence
- Evaluate whether appropriate consultation occurred

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## Threats to Objectivity

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- A self-review threat may be created when the engagement quality reviewer previously was involved with significant judgments made by the engagement team, in particular, as engagement partner or another engagement team member
- A familiarity or self-interest threat may arise when engagement quality reviewer is a close or immediate family member of the engagement partner or another member of engagement team, or through close personal relationships with members of the engagement team
- An intimidation threat may be created when actual or perceived pressure is exerted on the engagement quality reviewer (for example, when the engagement partner is an aggressive or dominant individual, or the engagement quality reviewer has a reporting line to the engagement partner)

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## Timing

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- Engagement partner is precluded from dating the report until notification has been received from the engagement quality reviewer that the engagement review is complete

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## Effective Date

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- For audits or reviews of financial statements for periods beginning on or after December 15, 2025
- Other engagements in A&A practice beginning on or after December 15, 2025

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## SAS 146

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### **Quality Management for an Engagement Conducted in Accordance with GAAS**

- Issued: June 2022

#### Background:

- Alignment with IAASB QM project

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## Scope

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- Addresses the specific responsibility of the auditor at the engagement level
- SQMS not applicable to government audit organizations
  - SAS does if following GAAS

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## Role of Engagement Team

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- Engagement team, including partner, is responsible for
  - Implementing the firm's response to quality risks
  - Determining whether to design and implement responses at the engagement level beyond those in firm's policies or procedures
  - Communicate to the firm information that is required to be communicated by the firm's policies and procedures that support the design, implementation and operation of the firm's system of QM

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## Responsibilities

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- Engagement partner is ultimately responsible for compliance with quality requirements
- The phrase “take responsibility for . . .” is used for those requirements for which the engagement partner is permitted to assign the design or performance of procedures, tasks, or actions to appropriately skilled or suitably experienced members of the engagement team
  - For other requirements, expressly intends that the requirement or responsibility be fulfilled by the engagement partner

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## Monitoring

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- EP should take responsibility for
  - Obtaining an understanding of the information from firm’s monitoring and remediation process
  - Determine the relevance and effect on engagement
  - Remain alert throughout the engagement that may be relevant to firm’s monitoring and remediation process and communicate such information

94

## Overall Responsibility

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- Prior to dating the report, Engagement Partner should determine that
  - Engagement partner's involvement has been sufficient and appropriate
  - Nature and circumstances of the audit engagement and firm's policies and procedures have been taken into account

95

## Effective Date

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- For engagements conducted in accordance with GAAS for periods beginning on or after December 15, 2025

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## SSARS 27

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### Quality Management for an Engagement Conducted In Accordance with SSARS - 2022

- Issued: June 2022

#### Background:

- SQMS 1 & 2
- SAS QM

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## Background

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- QC applies to all CPA firms with respect to engagements in their accounting and auditing practice
  - i.e., comps and reviews

98

## Effective Date

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- Effective for engagements performed in accordance with SSARs for periods ending on or after December 15, 2025

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SAS 147



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## SAS 147

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### **Inquiries of the Predecessor Auditor Regarding Fraud and Noncompliance With Laws and Regulations**

- Issued: June 2022

#### Background:

- Ethics interpretation changes
  - Responding to Noncompliance With Laws and Regulations (ET sec. 1.180.010 and ET sec. 2.180.010 )



## Inquiry of Predecessor Auditor

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- If management authorizes the predecessor auditor to respond to the auditor's inquiries, the auditor should inquire of the predecessor auditor about matters that will assist the auditor in determining whether to accept the engagement, including
  - Identified or suspected fraud involving
    - Management,
    - Employees who have significant roles in internal control, or
    - Others, when the fraud resulted in a material misstatement in the financial statements
  - Matters involving noncompliance or suspected noncompliance with laws and regulations that came to the predecessor auditor's attention during the audit, other than when matters are clearly inconsequential

## Interplay with Ethics

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- The predecessor auditor has a responsibility to respond to the auditor's inquiries on a timely basis and on the basis of known facts, absent unusual circumstances and unless prohibited by applicable law
- However, if the predecessor auditor decides, due to impending, threatened, or potential litigation; disciplinary proceedings; or other unusual circumstances, not to fully respond to the auditor's inquiries, the predecessor auditor should clearly state that the response is limited
  - Such unusual circumstances are expected to be rare

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## Documentation

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- When the engagement is accepted, the auditor should document
  - The inquiries of the predecessor auditor and
  - The results of those inquiries

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## Effective Date

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- For audits of financial statements for periods beginning on or after June 30, 2023

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SAS 148



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## SAS 148

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### Amendment to AU-C Section 935

- Issued: August 2022

#### Background:

- AU-C 935 addresses the application of GAAS to a compliance audit
  - Provides a list of standards that are not relevant to a compliance audit in the appendix

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## Update

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- Updated appendix with respect to recent SAS issuances
- Removed inconsistencies between 315 and 330 within 935

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## Effective Date

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- The amendment relating to AU-C 501 in the Appendix is effective for compliance audits for fiscal periods ending on or after December 15, 2022
  - Consistent with the effective date of SAS 142
- All other amendments are effective for compliance audits for fiscal periods ending on or after December 15, 2023
  - Consistent with the effective date of SAS 145



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# What Questions Do You Have?

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