Question
When a CPA firm completes an audit of a business and issues a report, does it express an opinion on the client's accounting records, financial statements, or both? Give reasons.

Solution:
The auditors' report expresses an opinion on the client's financial statements, not on the accounting records.
IF it’s a public company then the auditing firm expresses an additional opinion on the internal controls (which is more specific than "accounting records"). The two opinions combined are referred to as an “integrated audit”.

AI CPA GAAS
REMEmber that AICPA Auditing Standards only apply to non-public entities

There are 10 standards, which fall into three categories:
1. General standards
   - The firm and planning
2. Standards of fieldwork
   - Performing the audit
3. Standards of reporting
   - Issuance of the opinion

Generally Accepted Auditing Standards (issued by AICPA)

- General Standards
  - Adequate technical training and proficiency as an auditor.
  - Independence in mental attitude is to be maintained by the auditor.
  - Due professional care is to be exercised.
Standards of Fieldwork

- Work is to be adequately planned and properly supervised
- Sufficient understanding of the company and its environment (including internal controls) is to be obtained
- Sufficient competent evidential matter is to be obtained to afford a reasonable basis for the opinion

Standards of Reporting

- Whether the financial statements are in accordance with GAAP
- Note any instances where standards have NOT been consistently applied
- If informative disclosures are lacking, the report must state so.
- Render an opinion on compliance with GAAP.

BOILED DOWN:

Audit purpose is to perform sufficient work to reduce “audit risk” to a sufficiently low level.

AUDIT RISK:
The risk that a MATERIAL misstatement may go undetected.
- What is material?
  - Considers both Quantitative and Qualitative measures.
- Misstatements may be cause by:
  - Errors (unintentional mistakes)
  - Fraud (some degree of intent)

Auditor Responsibility for the Detection of Errors and Fraud

- Obtain information to assess the inherent risks and fraud risks
  - Information about the company and its environment
  - Discussion among audit team members
  - Inquiries of management and others
  - Planning analytical procedures, including those involving revenue
- Assess the risk of errors and fraud that may cause the financial statements to contain a material misstatement.
- Based on that assessment, plan and perform the audit to obtain reasonable assurance that material misstatements, whether caused by errors or fraud, will be detected (including those procedures required by SAS No. 99).
- Exercise due care in planning, performing and evaluating the results of audit procedures, and the proper degree of professional skepticism to achieve reasonable assurance that material misstatements due to error or fraud will be detected.
Auditor Responsibility for the Detection of Illegal Acts

- Those that could have a direct and material effect on financial statement amounts—same as for errors and fraud. An audit obtains reasonable assurance of detecting these types of illegal acts.
- Those with an indirect effect on financial statement amounts:
  - Be aware of possible occurrence.
  - If information comes to the auditor's attention, apply audit procedures directed at determining whether an illegal act has occurred. An audit does not provide assurance that indirect-effect illegal acts will be detected.

The Standard Auditors’ Report

- Title
- Addressee
- Content
  - What was audited
  - Audit guidance followed (GAAS/ PCAOB)
  - Opinion
  - Signature
  - Date

SEE EXAMPLE AT “INTRO” SLIDES OR CHAPTER 17 SLIDES

Elements of Quality Control

“HELP ME”

- Human resources
- Engagement/ client acceptance & continuance
- Leadership assignments
- Performance of the engagement
- Monitoring
- Ethical requirements

TYPES OF OPINIONS

1. UNQUALIFIED: WHAT THEY ALL WANT/EXPECT. “present fairly in all material respects”

2. QUALIFIED: Something ain’t quite right, but not so bad as to make the financial statements misleading. Could be a departure from GAAP
   - Could be a minor scope limitation
   - Could be a departure from GAAP which is not so bad as to make the financial statements misleading

3. ADVERSE: Something is so screwed up that auditor believes that the financial statements are NOT fairly presented. I’VE NEVER SEEN ONE- WHY EVEN BOTHER ISSUING?!

4. DISCLAIMER: For some reason, we could not do the audit. (perhaps opening inventory is not available or the basis in a piece of property can not be ascertained)

ALL BUT THE UNQUALIFIED OPINION REQUIRE A FOURTH “EXPLANATORY” PARAGRAPH
Regulation of the Public Accounting Profession—Public Companies

**Composition**
- Two members who have been CPA’s
- Three members cannot be or have been CPA’s
- None of Board members may receive pay/profit from CPA firms

**Public Company Accounting Oversight Board & the SEC**
- Regulation of public accounting firms that audit public companies
- Conduct or audit/quality controls, ethics, independence and other standards for auditors of public companies
- Requires or conduct inspections of registered public accounting firms
- Requires audit of internal controls
- Requires audit of internal controls
- Requires audit committee approval of all non-audit services
- Requires auditor independence

**Irony**
- Accounting changes rapidly and no current CPA is required to be on PCAOB!
- The internal controls of the PCAOB were not audited until 2007
- The fees they collected from fines, which are supposed to go to scholarships, have been substantially retained by the PCAOB with $7.0 million collected since inception and only $2.7 million (39%) paid toward scholarships
- Is a “non-profit”
- Net Assets (read as Retained earnings) is $145 million at 12/31/14
- Over a quarter of a billion of revenues in 2014
- $19 million of Increase in Unrestricted Net assets (read as “Net Income” in 2014… 7% net profit margin!)
- Highest paid officer compensation is not disclosed in financial reporting as is required of public companies… but we do know that each of the 5 Board members each earn over $500,000/year
- We also know that PCAOB matches 100% (up to 7% of comp) with immediate vesting which totaled $8.5 million in 2014.

MORE STUFF

- SAS’S REPRESENT A “MINIMUM”, FIRM STANDARDS ARE GENERALLY MORE STRINGENT
- AUDIT RISK= Risk that a material misstatement will not be detected. Goal of an audit is to reduce this to as low a level as possible without getting too crazy
  - What is material?
  - CONSIDERS BOTH QUALITATIVE AS WELL AS QUANTITATIVE FACTORS
- Adequacy of Disclosures:
  - “Transparency” – all information that an reasonable and informed user would consider significant to their decision-making.
- Peer Review: PCAOB reviews and monitors “Registered” Firms and their audits of public companies. Non-Registered firms are required to have a peer review as part of the AICPA requirements.
- IAS: Convergence in process as the world is shrinking!!