2024 AICPA Audit Update

May 13, 2024

1

General Disclaimer

Galasso Learning Solutions provides non-authoritative guidance on accounting, auditing, attestation, compilation, review, and tax standards. The information in this presentation should not be viewed as an official position of the AICPA, FASB, GASB, IRS or any other standard setters.

Official positions of standard setters are determined through certain specific committee procedures, due process, and extensive deliberation.

Application of accounting and auditing principles is the responsibility of an organization's management and their independent public accountant.

2

Galasso Learning Solutions ©2024

Learning Objectives

1. Recall the impact of recently issued SASes
2. Describe changing coming for quality management
3. Identify standards that will be implemented in future years

GALASSO LEARNING SOLUTIONS

3

Galasso Learning Solutions ©2024

Agenda

- SAS 145
- SAS 143
- SAS 147
- SAS 148
- AICPA Quality Management
- 2024 Yellow Book
- SAS 149

GALASSO LEARNING SOLUTIONS

4

4

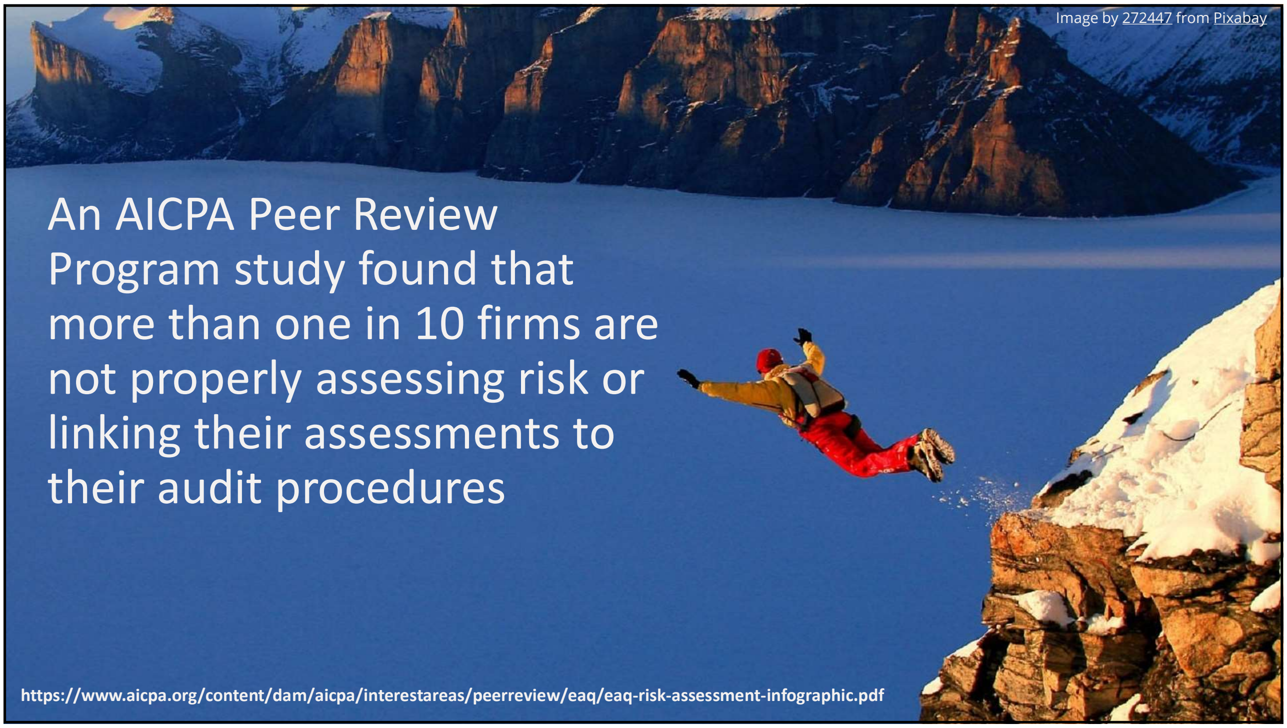
SAS 145

5

Common Deficiency

- Deficiencies in the auditor's risk assessment procedures is a common issue identified by practice monitoring programs in the United States and worldwide
  - In 2020 U.S. peer reviews, AU-C section 315 was the leading source of matters for further consideration (MFCs), constituting 25% of MFCs

6



7

Other Statistics

40%	of identified issues related to failure to gain an understanding of internal control when identifying the client's risks
14%	of issues related to incomplete or nonexistent risk assessment
24%	of issues related to auditors not linking their risk assessment to their response
13%	of issues related to auditors assessing control risk as less than high without appropriate tests of controls

8

Peer Review Findings

- Risk Assessment is Very Limited or Nonexistent
- No Linkage between Assessed Risks & Planned Responses
- Improper Use of 3rd Party Practice Aids
- Failure to Properly Respond to Significant Risks
- Repeating the Same Approach for Clients in the Same Industry

GALASSO LEARNING SOLUTIONS

https://www.journalofaccountancy.com/issues/2018/aug/risk-assessment-compliance.html

Goal

- The ASB's project to enhance the auditing standards relating to the auditor's risk assessment was intended to enable auditors to appropriately address the following:
  - Understanding the entity's system of internal control, in particular, relating to the auditor's work effort to obtain the necessary understanding
  - Modernizing the standard in relation to IT considerations, including addressing risks arising from an entity's use of IT
  - Determining risks of material misstatement, including significant risks

GALASSO LEARNING SOLUTIONS

Convergence

- The ASB has a strategic objective to converge with the International Standards on Auditing (ISAs)
  - ISA 315, Identifying and Assessing the Risks of Material Misstatement (Revised 2019) was used as the base

11

Basics

12

Objective

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

GALASSO LEARNING SOLUTIONS

13

13

Not Changing

- 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

GALASSO LEARNING SOLUTIONS

14

14

Levels of Risks

- Risks at the financial statement level relate pervasively to the financial statements as a whole and potentially affect many assertions

GALASSO LEARNING SOLUTIONS

15

15

Levels of Risks Cont'd

- RMM is assessed at the assertion level in order to determine the nature, timing, and extent of further audit procedures necessary to obtain sufficient appropriate audit evidence

GALASSO LEARNING SOLUTIONS

16

16

Relevant Assertions - Defined

- An assertion about a class of transactions, account balance, or disclosure is relevant when it has an identified risk of material misstatement
  - The determination of whether an assertion is a relevant assertion is made before consideration of any related controls (i.e. based on inherent risk)

GALASSO LEARNING SOLUTIONS

17

17

Relevant Assertions Cont'd

- Includes a conforming amendment to perform substantive procedures for each relevant assertion of each significant class of transactions, account balance, and disclosure, regardless of the assessed level of control risk
  - Rather than for all relevant assertions related to each **material** class of transactions, account balance, and disclosure, irrespective of the assessed RMM, as previously required

GALASSO LEARNING SOLUTIONS

18

18

RMM

- Risks of material misstatement at the assertion level consist of two components:
  - Inherent risk is described as the susceptibility of an assertion about a class of transactions, account balance, or disclosure to a misstatement that could be material, either individually or when aggregated with other misstatements, before consideration of any related controls
  - Control risk is described as the risk that a misstatement that could occur in an assertion about a class of transactions, account balance, or disclosure and that could be material, either individually or when aggregated with other misstatements, will not be prevented, or detected and corrected, on a timely basis by the entity's system of internal control

19

IR & CR

- A separate assessment of inherent risk and control risk is required

GALASSO LEARNING SOLUTIONS 20

20

RMM Cont'd

- A risk of material misstatement exists when
  - There is a reasonable possibility of a misstatement occurring (likelihood), and
  - If it were to occur, there is a reasonable possibility of the misstatement being material (magnitude)

Spectrum of Risk

- Inherent risk is higher for some assertions and related classes of transactions, account balances, and disclosures than for others
  - The degree to which the level of inherent risk varies is referred to as the spectrum of inherent risk

Significant - Defined

- Significant class of transactions, account balance, or disclosure
  - A class of transactions, account balance, or disclosure for which there is one or more relevant assertions

Cause of Risk

- Risks of material misstatement identified and assessed by the auditor include both those due to error and those due to fraud

Scalability

- Requirements are intended for audits of all entities, regardless of size or complexity
  - Application material incorporates considerations specific to both less and more complex entities, where appropriate
- Although the size of an entity may be an indicator of its complexity, some smaller entities may be complex, and some larger entities may be less complex

Galasso Learning Solutions ©2024

Modernization for an Evolving Business Environment

- Additional guidance that addresses significant changes in, and the evolution and increasingly complex nature of, the economic, technological, and regulatory aspects of the markets and environment in which entities and audit firms operate
  - Recognizes the ability to use automated tools and techniques (including audit data analytics) when performing risk assessment procedures

Iterative Process

- The auditor's risk identification and assessment process is iterative and dynamic
- Initial expectations of risks may be developed, which may be further refined as the auditor progresses through the risk identification and assessment process
  - The auditor must revise the risk assessments and modify further overall responses and further audit procedures, based on audit evidence obtained from performing further audit procedures in accordance with AU-C section 330, or if new information is obtained

27

Response

- AU-C section 330 requires the auditor to design and implement overall responses to address the assessed risks of material misstatement at the financial statement level
- AU-C section 330 further explains that the auditor's assessment of the risks of material misstatement at the financial statement level, and the auditor's overall responses, is affected by the auditor's understanding of the control environment
- AU-C section 330 also requires the auditor to design and perform further audit procedures whose nature, timing, and extent are based on and are responsive to the assessed risks of material misstatement at the relevant assertion level

28

Requirements

29

Risk Assessment

- The auditor should design and perform risk assessment procedures to obtain audit evidence that provides an appropriate basis for
  a) The identification and assessment of risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels, and
  b) The design of further audit procedures in accordance with AU-C section 330
- The auditor should design and perform risk assessment procedures in a manner that is not biased towards obtaining audit evidence that may be corroborative or towards excluding audit evidence that may be contradictory

30

RAP

The risk assessment procedures should include:

- Inquiries of management and of other appropriate individuals within the entity, including individuals within the internal audit function (if the function exists)
- Analytical procedures
- Observation and inspection

Audit Evidence

- In obtaining audit evidence, the auditor should consider information from
  - The auditor's procedures regarding acceptance or continuance of the client relationship or the audit engagement, and
  - When applicable, other engagements performed by the engagement partner for the entity

Prior Evidence: When the auditor intends to use information obtained from the auditor's previous experience with the entity and from audit procedures performed in previous audits, the auditor should evaluate whether such information remains relevant and reliable as audit evidence for the current audit

Engagement Team Discussion

- The engagement partner and other key engagement team members should discuss the application of the applicable financial reporting framework and the susceptibility of the entity's financial statements to material misstatement

When there are engagement team members not involved in the engagement team discussion, the engagement partner should determine which matters are to be communicated to those members

GALASSO LEARNING SOLUTIONS

33

33

Inherent Risk

34

Changes

- Includes 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 FRF

35

Understanding the Entity

- The auditor should perform risk assessment procedures to obtain an understanding of
  - Aspects of the entity and its environment:
    - The entity’s organizational structure, ownership and governance, and its business model, including the extent to which the business model integrates the use of IT
    - Industry, regulatory, and other external factors
    - The measures used, internally and externally, to assess the entity’s financial performance
  - The applicable FRF and the entity’s accounting policies and the reasons for any changes thereto
  - How inherent risk factors affect the susceptibility of assertions to misstatement and the degree to which they do so, in the preparation of the financial statements in accordance with the applicable FRF

36

Entity Level Risks

- An entity may
  - Have multiple legacy IT systems in diverse businesses that are not well integrated, resulting in a complex IT environment
  - Be using external or internal service providers for aspects of its IT environment (for example, outsourcing the hosting of its IT environment to a third party or using a shared service center for central management of IT processes in a group)

Inherent Risk Factors

- Characteristics of events or conditions that affect the susceptibility to misstatement, whether due to fraud or error, of an assertion about a class of transactions, account balance, or disclosure, before consideration of controls

Inherent Risk Factors Cont'd

- Inherent risk factors may be qualitative or quantitative and affect the susceptibility of assertions to misstatement

GALASSO LEARNING SOLUTIONS

39

39

Inherent Risk Factors Cont'd

- Qualitative inherent risk factors relating to the preparation of information required by the applicable FRF include:
  - Complexity
  - Subjectivity
  - Change
  - Uncertainty
  - Susceptibility to misstatement due to management bias or other fraud risk factors insofar as they affect inherent risk

GALASSO LEARNING SOLUTIONS

40

40

Appendix B

Relevant inherent risk factor	Examples of events and conditions that may indicate the existence of risks of material misstatement at the assertion level
Complexity	Regulatory: • Operations that are subject to a high degree of complex regulation Business model: • The existence of complex alliances and joint ventures Applicable financial reporting framework: • Accounting measurements that involve complex processes Transactions: • Use of off-balance-sheet financing, variable interest entities, and other complex financing arrangements
Subjectivity	Applicable financial reporting framework: • A wide range of possible measurement criteria of an accounting estimate, for example, management's recognition of depreciation or construction income and expenses • Management's selection of a valuation technique or model for a noncurrent asset, such as investment properties

41

Spectrum of Inherent Risk

- Depending on the degree to which the inherent risk factors affect the susceptibility of an assertion to misstatement, the level of inherent risk varies on a scale that is referred to as the spectrum of inherent risk

42

Accounting Policies

- The auditor should evaluate whether the entity's accounting policies are appropriate and consistent with the applicable financial reporting framework

Control Risk

Obtaining an Understanding of the Entity

- Elevates the importance of understanding the applicable financial reporting framework by restructuring the previous requirements
- A new explicit requirement to understand the use of IT in the entity's structure, ownership and governance, and business model

Entity's System of Internal Control

- 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

System of Internal Control - Defined

- The system designed, implemented, and maintained by those charged with governance, management, and other personnel to provide reasonable assurance about the achievement of an entity's objectives with regard to reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations

GALASSO LEARNING SOLUTIONS

47

47

System of Internal Control Cont'd

- For purposes of GAAS, the system of internal control consists of five interrelated components:
  i. Control environment
  ii. The entity's risk assessment process
  iii. The entity's process to monitor the system of internal control
  iv. The information system and communication
  v. Control activities

GALASSO LEARNING SOLUTIONS

48

48

Controls - Defined

- Policies or procedures that an entity establishes to achieve the control objectives of management or those charged with governance
- In this context
  - Policies are statements of what should, or should not, be done within the entity to effect control. Such statements may be documented, explicitly stated in communications, or implied through actions and decisions.
  - Procedures are actions to implement policies

GALASSO LEARNING SOLUTIONS

49

49

Control Environment

- The auditor should, through performing risk assessment procedures, obtain an understanding of the control environment relevant to the preparation of the financial statements by
  a) Understanding the set of controls, processes & structures addressing
     - How management's oversight responsibilities are carried out, e.g. the entity's culture and management's commitment to integrity and ethical values;
     - When those charged with governance are separate from management, the independence of, and oversight over the entity's system of internal control by, those charged with governance;
     - The entity's assignment of authority and responsibility;
     - How the entity attracts, develops, and retains competent individuals;
     - How the entity holds individuals accountable for their responsibilities in the pursuit of the objectives of the system of internal control; and

50

Control Environment Cont'd

b. Evaluating, based on the auditor's understanding obtained, whether
   - Management, with the oversight of those charged with governance, has created and maintained a culture of honesty and ethical behavior;
   - The control environment provides an appropriate foundation for the other components of the entity's system of internal control considering the nature and complexity of the entity; and
   - Control deficiencies identified in the control environment undermine the other components of the entity's system of internal control

Maintaining Professional Skepticism

- Clarifying that an appropriate understanding of the entity and its environment, and the applicable FRF, provides a foundation for being able to maintain professional skepticism throughout the audit
- Highlighting the benefits of maintaining professional skepticism during the required engagement team discussion
- Highlighting that contradictory evidence may be obtained as part of the auditor's risk assessment procedures

Risk Assessment

- The auditor should, through performing risk assessment procedures, obtain an understanding of the entity's risk assessment process relevant to the preparation of the financial statements by
  - Understanding the entity's process for
    - Identifying business risks, including the potential for fraud, relevant to financial reporting objectives;
    - Assessing the significance of those risks, including the likelihood of their occurrence;
    - Addressing those risks; and
  - Evaluating, based on the auditor's understanding obtained, whether the entity's risk assessment process is appropriate to the entity's circumstances considering the nature and complexity of the entity

53

Business Risk - Defined

- A risk resulting from significant conditions, events, circumstances, actions, or inactions that could adversely affect an entity's ability to achieve its objectives and execute its strategies, or from the setting of inappropriate objectives and strategies

54

Monitoring

- The auditor should obtain an understanding of the entity's process for monitoring the system of internal control relevant to the preparation of the financial statements by
  - Understanding those aspects of the entity's process that address
    - Ongoing and separate evaluations for monitoring the effectiveness of controls and the identification and remediation of control deficiencies identified and
    - The entity's internal audit function, if any, including its nature, responsibilities, and activities
  - Understanding the sources of the information used in the entity's process to monitor the system of internal control, and the basis upon which management considers the information to be sufficiently reliable for the purpose
  - Evaluating, based on the auditor's understanding obtained, whether the entity's process for monitoring the system of internal control is appropriate to the entity's circumstances considering the nature and complexity of the entity

55

Information & Communication

- The auditor should obtain an understanding of the entity's information system and communication relevant to the preparation of the financial statements by
  - Understanding the entity's information-processing activities, including its data and information, the resources to be used in such activities and the policies that define, for significant classes of transactions, account balances, and disclosures
    - How information flows through the entity's information system, including how
      - Transactions are initiated, and how information about them is recorded, processed, corrected as necessary, incorporated in the general ledger, and reported in the financial statements and
      - Information about events and conditions, other than transactions, is captured, processed, and disclosed in the financial statements,
    - The accounting records, specific accounts in the financial statements, and other supporting records relating to the flows of information in the information system,
    - The financial reporting process used to prepare the entity's financial statements, including disclosures, and
    - The entity's resources, including the IT environment

56

Galasso Learning Solutions ©2024

Information & Communication Cont’d

- Understanding how the entity communicates significant matters that support the preparation of the financial statements and related reporting responsibilities in the information system and other components of the system of internal control
  - Between people within the entity, including how financial reporting roles and responsibilities are communicated,
  - Between management and those charged with governance,
  - With external parties, such as those with regulatory authorities
- Evaluating, based on the auditor’s understanding obtained, whether the entity’s information system and communication appropriately support the preparation of the entity’s financial statements in accordance with the applicable financial reporting framework considering the nature and complexity of the entity

57

Galasso Learning Solutions ©2024

Example Control Activities

- Management verifies the sources and reliability of information used in making management decisions and executes monitoring controls
- Regarding managing user access rights, (1) rights are approved and granted based on job responsibilities; (2) rights, including super user access, are reviewed periodically; and (3) access is revoked in a timely manner
- Remote and third party access rights are managed to include timely revocation of rights
- Segregation of duties exists between development, testing, and production
- Effective channels for communication throughout the organization exist

58

Information System

- The information system relevant to the preparation of the financial statements consists of activities and policies, and accounting and supporting records, designed and established to do the following:
  - Initiate, record, and process entity transactions (as well as to capture, process, and disclose information about events and conditions other than transactions, such as changes in fair values or indicators of impairment) and to maintain accountability for the related assets, liabilities, and equity
  - Resolve incorrect processing of transactions, for example, automated suspense files and procedures followed to clear suspense items out on a timely basis
  - Process and account for system overrides or bypasses to controls
  - Incorporate information from transaction processing in the general ledger (for example, transferring of accumulated transactions from various data tables)
  - Capture and process information relevant to the preparation of the financial statements for events and conditions other than transactions, such as the depreciation and amortization of assets and changes in the recoverability of assets
  - Ensure information required to be disclosed by the applicable financial reporting framework is accumulated, recorded, processed, summarized, and appropriately reported in the financial statements

59

Control Activities Clarification

- Clarifies the requirement to evaluate the design and determine the implementation of certain controls within the control activities component

60

Control Activities

- The auditor should identify the following controls that address RMM at the assertion level:
  - Controls that address a risk that is determined to be a significant risk
  - Controls over journal entries and other adjustments as required by AU-C 240
  - Controls for which the auditor plans to test operating effectiveness in determining the nature, timing, and extent of substantive procedures, which should 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 are appropriate

GALASSO LEARNING SOLUTIONS

61

61

IT Controls

- The auditor should identify the IT applications and the other aspects of the entity's IT environment that are subject to risks arising from the use of IT
  - Identify the following:
    - The related risks arising from the use of IT
    - The entity's general IT controls that address such risks

GALASSO LEARNING SOLUTIONS

62

62

IT Controls Cont'd

- 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
  - Such controls might also be referred to as relevant controls or key controls in some audit methodologies

GALASSO LEARNING SOLUTIONS

63

63

General Information Technology (IT) Controls

- Controls over the entity's IT processes that support the continued proper operation of the IT environment, including the continued effective functioning of information-processing controls and the integrity of information in the entity's information system

GALASSO LEARNING SOLUTIONS

64

64

IT Environment - Defined

- The 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. For the purposes of this definition
  i. An IT application is a program or a set of programs that is used in the initiation, processing, recording, and reporting of transactions or information. IT applications include data warehouses and report writers.
  ii. The IT infrastructure comprises the network, operating systems, and databases and their related hardware and software
  iii. The IT processes are the entity's processes to manage access to the IT environment, manage program changes or changes to the IT environment, and manage IT operations

65

IT Applications

- The identification of IT applications on which the entity relies, may affect the auditor's decision to test the automated controls within such IT applications, assuming that such automated controls address identified risks of material misstatement
  - Examples: Automated calculations or input and processing and output controls, such as a three-way match of a purchase order, vendor shipping document, and vendor invoice
- When automated controls are identified by the auditor and the auditor determines through the understanding of the IT environment that the entity is relying on the IT application that includes those automated controls, it may be more likely for the auditor to identify the IT application as one that is subject to risks arising from the use of IT

66

Information-processing Controls

- Controls relating to the processing of information in IT applications or manual information processes in the entity's information system that directly address risks to the integrity of information

Risks Arising From the Use of IT & General IT Controls

- 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
  - General IT controls need not be identified for every IT process
  - General IT controls are identified based on the risks arising from the use of IT

Risk Considerations

- The extent to which the entity makes program or configuration changes and the extent to which the IT processes over such changes are formalized may also be relevant considerations
- The auditor is also likely to consider the risk of inappropriate access or changes to data

Examples

- Examples of risks arising from the use of IT include risks related to inappropriate reliance on IT applications that are inaccurately processing data, processing inaccurate data, or both, as follows:
  - Unauthorized access to data that may result in destruction of data or improper changes to data, including the recording of unauthorized or nonexistent transactions or inaccurate recording of transactions
    - Particular risks may arise when multiple users access a common database
  - The possibility of IT personnel gaining access privileges beyond those necessary to perform their assigned duties thereby breaking down segregation of duties
  - Unauthorized changes to data in master files
  - Unauthorized changes to IT applications or other aspects of the IT environment
  - Failure to make necessary changes to IT applications or other aspects of the IT environment
  - Inappropriate manual intervention
  - Potential loss of data or inability to access data as required

General IT Control Examples

- Process to manage access:
  - Authentication
    - Controls that validate that a user accessing the IT application or other aspect of the IT environment is using the user's own log-in credentials (that is, the user is not using another user's credentials)
  - Authorization
    - Controls that allow users to access the information necessary for their job responsibilities and nothing further, which facilitates appropriate segregation of duties
  - Provisioning
    - Controls to authorize new users and modifications to existing users' access privileges
  - Deprovisioning
    - Controls to remove user access upon termination or transfer

71

General IT Control Examples Cont'd

- Privileged access
  - Controls over administrative or powerful users' access
- User-access reviews
  - Controls to recertify or evaluate user access for ongoing authorization over time
- Security configuration controls
  - Each technology generally has key configuration settings that help restrict access to the environment
- Physical access
  - Controls over physical access to the data center and hardware because such access may be used to override other controls

72

Galasso Learning Solutions ©2024

General IT Control Examples Cont'd

- Process to manage program or other changes to the IT environment:
  - Change-management process
    - Controls over the process to design, program, test, and migrate changes to a production (that is, end user) environment
  - Segregation of duties over change migration
    - Controls that segregate access to make and migrate changes to a production environment
  - Systems development or acquisition or implementation
    - Controls over initial IT application development or implementation (or in relation to other aspects of the IT environment)
  - Data conversion
    - Controls over the conversion of data during development, implementation, or upgrades to the IT environment

73

Galasso Learning Solutions ©2024

General IT Control Examples Cont'd

- Process to manage IT operations:
  - Job scheduling
    - Controls over access to schedule and initiate jobs or programs that may affect financial reporting
  - Job monitoring
    - Controls to monitor financial reporting jobs or programs for successful execution
  - Backup and recovery
    - Controls to ensure backups of financial reporting data occur as planned and that such data is available and able to be accessed for timely recovery in the event of an outage or attack
  - Intrusion detection
    - Controls to monitor for vulnerabilities or intrusions in the IT environment

74

Direct vs. Indirect

- Direct controls are controls that are precise enough to address RMM at the assertion level
- Indirect controls are controls that support direct controls
  - Although indirect controls are not sufficiently precise to prevent, or detect and correct, misstatements at the assertion level, they are foundational and may have an indirect effect on the likelihood that a misstatement will be prevented or detected on a timely basis

GALASSO LEARNING SOLUTIONS

75

75

New Approach

Direct

- Control activities
  - For the identified controls that address risks of material misstatement at the assertion level, the auditor is required to evaluate the design and determine whether the controls have been implemented

Primarily Indirect

- Control environment, Risk Assessment, Monitoring
  - Does not require the auditor to evaluate the design or determine the implementation of individual controls within these components

GALASSO LEARNING SOLUTIONS

76

76

New Approach Cont'd

- Primarily More Direct Controls but May Be Indirect Controls
  - Information System and Communication
    - The auditor's identification and evaluation of controls in the control activities component is focused on information-processing controls, also known as transaction controls
    - Does not require the auditor to evaluate the design or determine the implementation of individual controls within the information and communication component

GALASSO LEARNING SOLUTIONS

77

77

Controls

- For each control identified (as required)
  - Evaluate whether the control is designed effectively to address the RMM at the assertion level or effectively designed to support the operation of other controls
  - Determine whether the control has been implemented by performing procedures in addition to inquiry of the entity's personnel

GALASSO LEARNING SOLUTIONS

78

78

Control Deficiencies

- Based on the auditor's understanding and evaluation of the components of the entity's system of internal control, the auditor should determine whether one or more control deficiencies have been identified
  - The auditor may determine that a significant deficiency or material weakness exists that affects the auditor's risk assessments and related response

GALASSO LEARNING SOLUTIONS

79

79

RMM

80

Identifying Risks

- The auditor should identify the risks of material misstatement and determine whether they exist at
  - The financial statement level
  - The assertion level for classes of transactions, account balances, and disclosures
- The auditor should determine the relevant assertions and the related significant classes of transactions, account balances, and disclosures

Assessing Risk at FS Level

- For identified risks of material misstatement at the financial statement level, the auditor should assess the risks and
  - Determine whether such risks affect the assessment of risks at the assertion level, and
  - Evaluate the nature and extent of their pervasive effect on the financial statements

Assessing Inherent Risk at Assertion Level

- For identified RMM at the assertion level, the auditor should assess inherent risk by assessing the likelihood and magnitude of misstatement
- Take into account how and the degree to which
  - Inherent risk factors affect the susceptibility of relevant assertions to misstatement, and
  - The RMM at the financial statement level affect the assessment of inherent risk for RMM at the assertion level

GALASSO LEARNING SOLUTIONS

83

83

Galasso Learning Solutions ©2024

Assessing Risk

- The auditor should determine whether any of the assessed RMM are significant risks
- The auditor should determine whether substantive procedures alone cannot provide sufficient appropriate audit evidence for any of the RMM at the assertion level

GALASSO LEARNING SOLUTIONS

84

84

Assessing Control Risk

- For identified RMM at the assertion level, the auditor should assess control risk based on the auditor's understanding of controls and the auditor's plan to test the operating effectiveness of controls
  - If the auditor does not plan to test the operating effectiveness of controls, the auditor should assess control risk at the maximum level such that the assessment of the **RMM is the same as the assessment of inherent risk**

GALASSO LEARNING SOLUTIONS

85

85

Significant Risk

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

GALASSO LEARNING SOLUTIONS

86

86

Evaluating Audit Evidence

- The auditor should evaluate whether the audit evidence obtained from the risk assessment procedures provides an appropriate basis for the identification and assessment of the RMM
  - If not, the auditor should perform additional risk assessment procedures until audit evidence has been obtained to provide such a basis
- In identifying and assessing the RMM, the auditor should take into account all audit evidence obtained from the risk assessment procedures, whether **corroborative or contradictory** to assertions made by management

GALASSO LEARNING SOLUTIONS

87

87

Not Significant but Material

- For material classes of transactions, account balances, or disclosures that have not been determined to be significant classes of transactions, account balances, or disclosures, the auditor should evaluate whether the auditor's determination remains appropriate
- All "material" accounts should be included in the risk assessment summary.
  - Then evaluate if the sections not classified as "significant" are properly classified.

GALASSO LEARNING SOLUTIONS

88

88

Iterative Process

- If the auditor obtains new information that is inconsistent with the audit evidence on which the auditor originally based the identification or assessments of the RMM, the auditor should revise the identification or assessment

89

Documentation

90

Audit Documentation

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

91

Effective Date

92

Effective Date

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

GALASSO LEARNING SOLUTIONS

93

93

Appendices

- 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

GALASSO LEARNING SOLUTIONS

94

94

SAS 143

95

SAS 143

Auditing Accounting Estimates and Related Disclosures

- Issued: July 2020

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

Update

Objective of Auditor

- To obtain sufficient appropriate audit evidence about whether accounting estimates and related disclosures in the financial statement are reasonable, in the context of the applicable financial reporting framework

Definitions

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

Examples of Estimates

Inventory obsolescence	Depreciation of property and equipment	Valuation of infrastructure assets, such as buildings and roadways
Valuation of financial instruments	Outcome of pending litigation	Provision for expected credit losses
Valuation of insurance contract liabilities	Warranty obligations	Employee retirement benefits liabilities
Share-based payments	Fair value of assets or liabilities acquired in a business combination, including the determination of goodwill and intangible assets	Impairment of long-lived assets or property or equipment held for disposal
Nonmonetary exchanges of assets or liabilities between independent parties	Revenue recognized for long-term contracts	

99

Scope

- 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)

100

Nature of Estimates

- 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

GALASSO LEARNING SOLUTIONS

101

101

Accounting Estimates

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

GALASSO LEARNING SOLUTIONS

102

102

Scalability

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

GALASSO LEARNING SOLUTIONS

103

103

Risk Assessment

- Separate assessment of inherent risk & control risk
- Specific risk factors identified

Estimation Uncertainty | Complexity | Subjectivity

GALASSO LEARNING SOLUTIONS

104

104

Estimation Uncertainty

- Arises when the required monetary amount for a FS item that is recognized or disclosed in the FS cannot be measured with precision through direct observation of the cost or price
  - The next most precise alternative measurement strategy is to apply a method that reflects the available knowledge about cost or price for the item on the relevant measurement basis, using observable data about relevant valuation attributes

GALASSO LEARNING SOLUTIONS

105

105

Galasso Learning Solutions ©2024

Estimation Uncertainty Cont'd

- Constraints on the availability of knowledge or data may limit the verifiability of inputs to the measurement process and limit the precision of measurement outcomes
- Most accounting frameworks acknowledge that there are practical constraints on the information that should be taken into account, such as when the cost of obtaining it would exceed the benefits

GALASSO LEARNING SOLUTIONS

106

106

Complexity

- Complexity gives rise to inherent risk
- Inherent complexity may arise when
  - There are many valuation attributes with many or nonlinear relationships between them
  - Determining appropriate values for one or more valuation attributes requires multiple data sets
  - More assumptions are required in making the accounting estimate, or when there are correlations between the required assumptions
  - The data used is inherently difficult to identify, capture, access, or understand

GALASSO LEARNING SOLUTIONS

107

107

Complexity Cont'd

- Complexity may be related to the complexity of the method and the computational process or model used to apply it
  - Complexity in the model may reflect the need to apply probability-based valuation concepts or techniques, option pricing formulae, or simulation techniques to predict uncertain future outcomes or hypothetical behaviors

GALASSO LEARNING SOLUTIONS

108

108

Subjectivity

- Subjectivity reflects inherent limitations in the knowledge or data reasonably available about valuation attributes
  - The applicable FRF may reduce the degree of subjectivity by providing a required basis for making certain judgments which may set explicit or implied objectives relating to measurement, disclosure, the unit of account, or the application of a cost constraint

GALASSO LEARNING SOLUTIONS

109

109

Subjectivity Cont'd

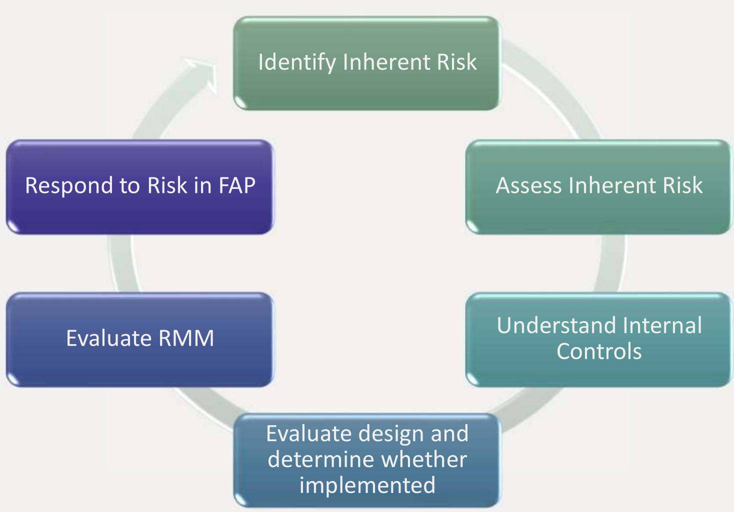
- Management judgment is generally needed in determining some or all of the following matters, which often involve subjectivity:
  - To the extent not specified under the requirements of the applicable financial reporting framework, the appropriate valuation approaches, concepts, techniques, and factors to use in the estimation method, having regard to available knowledge
  - To the extent valuation attributes are observable when there are various potential sources of data, the appropriate sources of data to use
  - To the extent valuation attributes are not observable, the appropriate assumptions or range of assumptions to make, considering the best available data, including, for example, market views
  - The range of reasonably possible outcomes from which to select management's point estimate, and the relative likelihood that certain points within that range would be consistent with the objectives of the measurement basis required by the applicable financial reporting framework
  - The selection of management's point estimate, and the related disclosures to be made, in the financial statements

110

Risk Assessment Cont'd

- Leverages 315 and 330 including decisions about whether
  - Controls are relevant and are required to be evaluated
  - To test the operating effectiveness

Risk Assessment Cont'd



Risk Assessment Cont'd

- The auditor's procedures to obtain the understanding should be performed to the extent necessary to provide an appropriate basis for the identification and assessment of RMM at the financial statement and relevant assertion levels

GALASSO LEARNING SOLUTIONS

113

113

Prior Estimates

- Review the outcome of previous accounting estimates or their subsequent re-estimation to assist in identifying and assessing the RMM in the current period
- Take into account the characteristics of the accounting estimates in determining the nature and extent of that review
  - Not intended to call into question judgments about previous-period accounting estimates that were appropriate based on the information available at the time they were made

GALASSO LEARNING SOLUTIONS

114

114

Use of Specialist

- Determine whether the engagement team requires specialized skills or knowledge to
  - Perform the risk assessment procedures
  - To identify and assess the RMM
  - To design and perform audit procedures to respond to those risks
  - To evaluate the audit evidence obtained

Inherent Risk

- Sliding scale of risk referred to as a spectrum of inherent risk

- Focus on use of professional skepticism

Inherent Risk Cont'd

- The degree to which the accounting estimate is subject to estimation uncertainty
- The degree to which one or both of the following are affected by complexity, subjectivity, or other inherent risk factors:
  - The selection and application of the method, assumptions, and data in making the accounting estimate
  - The selection of management's point estimate and related disclosures for inclusion in the financial statements

GALASSO LEARNING SOLUTIONS 117

117

Professional Skepticism

- Exercise of professional skepticism is affected by inherent risk factors
  - Importance increases when estimates are subject to a greater degree of estimation uncertainty or are affected to a greater degree by complexity, subjectivity or other inherent risk factors

GALASSO LEARNING SOLUTIONS 118

118

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

GALASSO LEARNING SOLUTIONS

119

119

Significant Risk

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

GALASSO LEARNING SOLUTIONS

120

120

Disclosures

- The auditor should design and perform further audit procedures to obtain sufficient appropriate audit evidence regarding the assessed RMM at the relevant assertion level for disclosures related to an accounting estimate, including those procedures related to estimation uncertainty

Management Bias

- Evaluate whether judgments and decisions, even if they are individually reasonable, indicate possible management bias
  - Evaluate implications
  - Consider if intent (fraud)

Overall Evaluation

- Evaluate whether
  - The assessments of the RMM at the relevant assertion level remain appropriate, including when indicators of possible management bias have been identified
  - Management's decisions relating to the recognition, measurement, presentation, and disclosure of these accounting estimates in the financial statements are in accordance with the applicable FRF
  - Sufficient appropriate audit evidence has been obtained

GALASSO LEARNING SOLUTIONS

123

123

Evaluation

- 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

GALASSO LEARNING SOLUTIONS

124

124

Documentation

- 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

GALASSO LEARNING SOLUTIONS

Effective Date

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

GALASSO LEARNING SOLUTIONS

SAS 147

127

SAS 147

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)

GALASSO LEARNING SOLUTIONS

128

128

Ethics Interpretation

129

Background

Responding to Noncompliance With Laws and Regulations

- Revised: March 2022

- Background:
  - IESBA convergence
  - Two proposals

130

Threat

- When a member encounters or is made aware of noncompliance or suspected noncompliance with laws and regulations in the course of providing a professional service to a client, threats to compliance with the "Integrity and Objectivity Rule" may exist

GALASSO LEARNING SOLUTIONS

131

131

Definition

Noncompliance

- Noncompliance with laws and regulations (noncompliance) comprises acts of omission or commission, intentional or unintentional, that are contrary to the prevailing laws or regulations and are committed by a client or by those charged with governance, by management, or by other individuals working for or under the direction of a client

GALASSO LEARNING SOLUTIONS

132

132

Client Confidentiality

- When responding to noncompliance or suspected noncompliance in the course of providing a professional service to a client, the member should consider the member's obligations under the "Confidential Client Information Rule"

GALASSO LEARNING SOLUTIONS

133

133

Responding to Noncompliance

- The objectives of a member are
  - To comply with the "Integrity and Objectivity Rule"
  - To alert management or, when appropriate, those charged with governance of the client, to enable them to
    - Rectify, remediate, or mitigate the consequences of the identified or suspected noncompliance; or
    - Deter the commission of the noncompliance when it has not yet occurred
  - To determine whether withdrawal from the engagement and professional relationship is necessary, when permitted by law and regulation
  - To take such further action as appropriate in the public interest
  - To comply with applicable laws, regulations, and the "Compliance With Standards Rule"

134

Scope

- This interpretation does not apply to the following:
  - Personal misconduct unrelated to the business activities of the client
  - Noncompliance by parties other than
    - The client,
    - Those charged with governance,
    - Management, or
    - Other individuals working for or under the direction of the client
  - A litigation or investigation engagement as defined in AICPA Statement on Standards for Forensic Services No. 1
  - An engagement where the primary purpose is to identify, reach a conclusion regarding, or otherwise respond to a known or potential NOCLAR
  - An engagement pursuant to which the protections set forth in IRC Section 7525 or any comparable state or local statutes apply
  - An engagement where compliance with this interpretation would cause a violation of law or regulation

135

Scope Cont'd

- Sets out the approach to be taken by a member who encounters or is made aware of noncompliance or suspected noncompliance with:
  - Laws and regulations generally recognized to have a direct effect on the determination of material amounts and disclosures in the client's financial statements
  - Other laws and regulations that do not have a direct effect on the determination of the amounts and disclosures in the client's financial statements, but compliance with which may be fundamental to the operating aspects of the client's business, to its ability to continue its business, or to avoid material penalties

136

Materiality

- A member who encounters or is made aware of matters that are clearly inconsequential is not required to comply with this interpretation with respect to such matters

Response

- When a member becomes aware of a matter to which this interpretation applies, the member should take timely steps to comply with this interpretation, taking into account the member's understanding of the nature of the matter and the potential harm to the interests of the entity, investors, creditors, employees, or the general public

Galasso Learning Solutions ©2024

Differences

Members Providing Financial Statement Audit or Review Services

Services Other Than a Financial Statement Audit or Review Service

GALASSO LEARNING SOLUTIONS

139

139

Galasso Learning Solutions ©2024

Effective Date

- The new interpretations and revisions are effective June 30, 2023
  - Early implementation is allowed

GALASSO LEARNING SOLUTIONS

140

140

Audit Response

141

Inquiry of Predecessor Auditor

- 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 FS
  - 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

GALASSO LEARNING SOLUTIONS

142

142

Interplay with Ethics

- 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

Documentation

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

Effective Date

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

145

SAS 148

146

SAS 148

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

GALASSO LEARNING SOLUTIONS

147

147

Update

- Amends AU-C 935 to addresses changes in

SAS 142, Audit Evidence

SAS 145, Risk Assessment

GALASSO LEARNING SOLUTIONS

148

148

Impact of SAS 145

149

Update

- AU-C 315A paragraphs .12c, .26–.30, and .33c are not applicable to a compliance audit
  - 12c – entities selection and application of accounting policies
  - 26-30 – identifying risk at FS and assertion level & significant risks
- Therefore, updated to include comparable paragraphs (19b, 20, 32–34, 36, and 42d) of SAS 145 as not applicable

150

Update Cont'd

- Paragraphs around controls over significant risks, and classes of transactions, account balances, and disclosures that are not significant but are material were added to the appendix as not applicable in a compliance audit
  - Historically, the concept of significant risks has not been applicable to a compliance audit
  - The concept of classes of transactions, account balances, and disclosures that are material is not applicable to a compliance audit

GALASSO LEARNING SOLUTIONS

151

151

Update Cont'd

- Certain control activities do apply to a compliance audit
  - Updates AU-C 935 to address controls over compliance that are required to be tested for operating effectiveness by a governmental audit requirement
  - Additional requirements related to control activities related to risks arising from the use of IT that also apply to a compliance audit

GALASSO LEARNING SOLUTIONS

152

152

Required Control Evaluation

- Controls over journal entries and other adjustments as required by 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, and
  - Controls that are required to be tested for operating effectiveness by the governmental audit requirement
- Other controls that, based on the auditor's professional judgment, the auditor considers appropriate to enable the auditor to identify and assess risks of material noncompliance and design further audit procedures

GALASSO LEARNING SOLUTIONS 153

153

Update Cont'd

- Paragraphs 35 & 37–38 related to assessing inherent risk and control risk in SAS 145 were added as requirements directly in AU-C 935 (adapted for compliance audits)
  - Consequentially, original text in 145 is not applicable

GALASSO LEARNING SOLUTIONS 154

154

Update Cont'd

- Extant AU-C 935 excludes requirements related to documenting the identified and assessed risks at the financial statement level and assertion level
  - New documentation requirement was added to AU-C 935 updated for compliance audits
    - "the identified and assessed risks of material noncompliance, including risks for which substantive procedures alone cannot provide sufficient appropriate audit evidence, and the rationale for the significant judgments made"

GALASSO LEARNING SOLUTIONS

155

155

Update Cont'd

- Addresses inconsistency between extant AU-C 935 regarding significant risks (315 vs 330 in appendix)
  - Now consistently not applicable
- Performing substantive procedures for each relevant assertion of each significant class of transactions, account balance, and disclosure added as not applicable

GALASSO LEARNING SOLUTIONS

156

156

Effective Date

- 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

GALASSO LEARNING SOLUTIONS

157

157

AICPA Quality Management

158

Suite of Standards

- SQMS1
- SQMS2
- SAS 146
- SSARS 26

The Why

- The environment in which firms operate has evolved
- The power and use of technological resources have increased exponentially, both by businesses and by firms
- The expectations of regulators, given high-profile business failures, are higher
- This model provides a more scalable approach to quality for firms of all sizes

The QM Standards in a Nutshell

- Increases firm leadership responsibilities and accountability, and improve firm governance
- Introduces a risk-based approach focused on achieving quality objectives
- Addresses technology, networks, and the use of external service providers
- Increases focus on the continual flow of information and appropriate communication internally and externally

The QM Standards in a Nutshell Cont'd

- Promotes proactive monitoring of quality management systems and timely and effective remediation of deficiencies
- Clarifies and strengthens requirements for a more robust engagement quality review (EQR)
- Enhances the engagement partner's (EP's) responsibility for audit engagement leadership and audit quality

SQMS No. 1

163

Background

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

- Issued: June 2022

- Background:
  - Alignment with IAASB
    - Replaces the concept of Quality Control to a more risk based ongoing process

GALASSO LEARNING SOLUTIONS

164

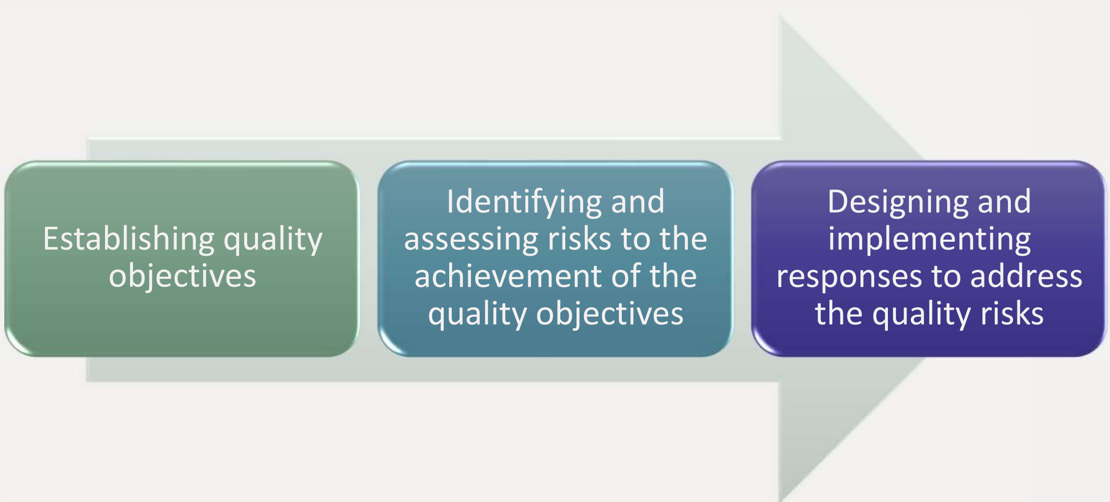
164

New Approach

- Shifts from a policies-based approach to a risk-based approach
- Emphasizes leadership responsibility in proactively managing quality that requires a firm to design, implement, and operate a system of quality management customized to the circumstances of the firm's A&A practice

GALASSO LEARNING SOLUTIONS

Risk Based Approach



GALASSO LEARNING SOLUTIONS

Evaluation

- At least annually, the individuals assigned ultimate responsibility and accountability for the system of QM, on behalf of the firm, evaluate the system of QM and conclude whether the system of QM provides the firm with reasonable assurance that the objectives of the system are being achieved

GALASSO LEARNING SOLUTIONS

167

167

Scalability

- There may not be personnel who have the competence, capabilities, time, or objectivity to perform the monitoring activities
  - May use network services or a service provider to perform the monitoring activities

GALASSO LEARNING SOLUTIONS

168

168

Responsibilities

- The firm should assign:
  - Ultimate responsibility and accountability for the system of quality management to the firm's CEO or managing partner (or equivalent)
  - Operational responsibility for the system of QM
  - Operational responsibility for specific aspects of the system of QM, including:
    - Compliance with independence requirements
    - The monitoring and remediation process

GALASSO LEARNING SOLUTIONS

169

169

Components of QM

170

Components of the System of QM

- The firm's risk assessment process (new)
- Governance and leadership (renamed & updated)
- Relevant ethical requirements
- Acceptance and continuance of client relationships and specific engagements
- Engagement performance
- Resources (renamed and expanded)
- Information and communication (new)
- Monitoring and remediation process (renamed & updated)

171

Components of the Quality System

Components of the Quality System Image. https://www.aicpa.org/resources/download/quality-management-standards-qm-roundtable-recording-and-presentation

172

Objective of the Firm

- The objective of the firm in the context of the standard is to design, implement, and operate a system of quality management that provides the firm with reasonable assurance that the objectives of the system of quality management are achieved

GALASSO LEARNING SOLUTIONS

173

173

Objective of System of QM

- The system of quality management is designed to achieve the following objectives:
  - 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
  - Engagement reports issued by the firm are appropriate in the circumstances

GALASSO LEARNING SOLUTIONS

174

174

Effective Date

175

Effective Date

- Systems of quality management are required to be designed and implemented by December 15, 2025
- The evaluation of the system of quality management is required to be performed within one year following December 15, 2025

GALASSO LEARNING SOLUTIONS

176

176

2024 Yellow Book

177

Background

Government Auditing Standards 2024 Revision

- Issued: February 1, 2024

- Background:
  - Contains major changes from, and supersedes, Government Auditing Standards 2018 Revision Technical Update April 2021
    - Chapter 5, "Quality Management, Engagement Quality Reviews, and Peer Review" in the 2024 revision replaces Chapter 5, "Quality Control and Peer Review," in the 2018 Revision
    - Application guidance is added to Chapter 6, "Standards for Financial Audits"

178

Major Changes

- Some of the changes in the 2024 Revision of Government Auditing Standards reflect:
  - An emphasis on the responsibility of an audit organization's leadership for proactively managing quality on its engagements
  - An approach that promotes scalability of the system of quality management for use by audit organizations differing in size and complexity
  - A risk-based process for achieving the objectives of quality management
  - A change in approach from quality control to quality management
  - Flexibility for audit organizations subject to other quality management standards to avoid the burden of designing, implementing, and operating separate systems of quality management
  - Promotion of proactive and effective monitoring activities and increased emphasis on tailoring monitoring activities
  - Provisions for optional engagement quality reviews of GAGAS engagements
  - Application guidance on key audit matters for when they may apply to financial audits of government entities and entities that receive government financial assistance

179

Convergence

- Aligns significantly with AICPA & IAASB QM standards
  - Same effective date as AICPA

GALASSO LEARNING SOLUTIONS

180

180

Quality Management Overview

181

Objective

- The objective of a system of QM is to provide the audit organization with reasonable assurance that the audit organization and its personnel
  - Fulfill their responsibilities in accordance with professional standards and applicable laws and regulations and
  - Perform and report on engagements in accordance with such standards and requirements

GALASSO LEARNING SOLUTIONS

182

182

Components of QM

- Governance and leadership
- Independence, legal, and ethical requirements
- Acceptance, initiation, and continuance of engagements
- Engagement performance
- Resources
- Information and communication

GALASSO LEARNING SOLUTIONS

183

183

Processes

- The risk assessment process includes assessing and responding to risks to achieving the quality objectives
- The monitoring and remediation process includes
  - Providing relevant, reliable, and timely information about the design, implementation, and operation of the system of quality management
  - Taking appropriate actions to respond to and remediate identified deficiencies in the system of quality management
  - Enabling the audit organization to assess compliance with professional standards and with policies and procedures it has established to address quality risks

GALASSO LEARNING SOLUTIONS

184

184

Risk Based Approach

- Establishing the desired outcomes relative to the components of the system of quality management
  - Referred to as quality objectives
- Identifying and assessing risks to achieving the quality objectives
  - Referred to as quality risks
- Designing and implementing responses to address quality risks

GALASSO LEARNING SOLUTIONS

185

185

Requirements

- An audit organization must design, implement, and operate a system of quality management that provides it with **reasonable assurance** that the audit organization and its personnel
  - Fulfill their responsibilities in accordance with professional standards and applicable laws and regulations and
  - Perform and report on engagements in accordance with such standards and requirements

GALASSO LEARNING SOLUTIONS

186

186

Nongovernment Audit Orgs

- A nongovernment audit organization subject to the quality management standards of recognized organizations should comply with the respective organization's QM requirements and the requirements of paragraphs 5.55c, 5.55d, & 5.74c
- Recognized Orgs
  - American Institute of Certified Public Accountants
  - International Auditing and Assurance Standards Board
  - Public Company Accounting Oversight Board

GALASSO LEARNING SOLUTIONS

187

187

Additional Requirements

- 5.55c
  - If an engagement is terminated before it is completed and an audit report is not issued, document the results of the work to the date of termination and why the engagement was terminated
- 5.55d
  - If auditors change the engagement objectives during the engagement, document the revised engagement objectives and the reasons for the changes

GALASSO LEARNING SOLUTIONS

188

188

Additional Requirements Cont'd

- 5.74c
  - Auditors who are performing work in accordance with GAGAS meet the continuing professional education (CPE) requirements

GALASSO LEARNING SOLUTIONS

189

189

Government Audit Organizations

- Government audit organizations should comply with the GAGAS quality management requirements in paragraphs 5.05 through 5.138 and, if applicable, engagement quality review requirements in paragraphs 5.139 through 5.154

GALASSO LEARNING SOLUTIONS

190

190

Non-Govs Not Subject to Recognized Orgs

- Nongovernment audit organizations not subject to the quality management standards of one of the recognized organizations in paragraph 5.07 should comply with the GAGAS quality management requirements in paragraphs 5.05 through 5.138 and, if applicable, engagement quality review requirements in paragraphs 5.139 through 5.154

GALASSO LEARNING SOLUTIONS

191

191

SAS 149

192

SAS 149

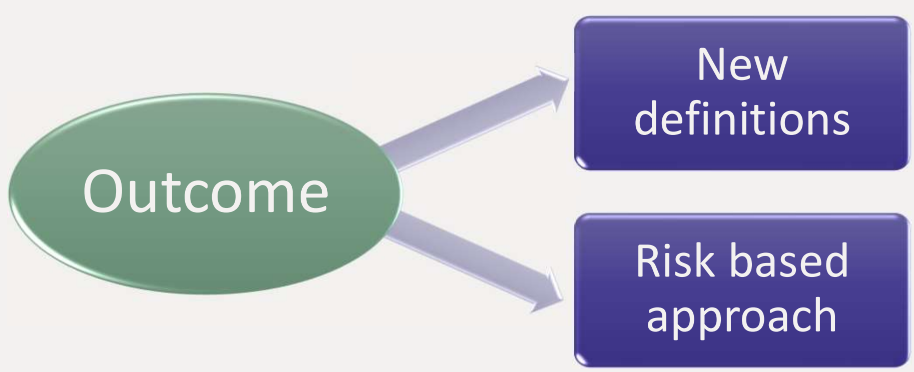
Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)

- Issued: March 2023

- Background:
  - Convergence with IAASB

Background

- Common Audit Deficiency in Peer Review



Definition

Component

- An entity, business unit, function, or business activity determined by the group auditor for purposes of planning and performing audit procedures in a group audit
  - The group auditor uses professional judgment in determining components at which audit work will be performed

GALASSO LEARNING SOLUTIONS

195

195

Groups & Components

- Group financial statements include the financial information of more than one entity or business unit through a consolidation process

A group may be organized in various ways

- Parent / Sub
- JVs
- Equity method investments
- Branches/Divisions
- Functions/Business Activities

196

New Definition

Referred-To Auditor

- An auditor who performs an audit of the financial statements of a component to which the group engagement partner determines to make reference in the auditor’s report on the group financial statements
- A referred-to auditor is not a component auditor, and accordingly, is not a part of the engagement team for a group audit

Revised Definition

Component Auditor

- An auditor who performs audit work related to a component for purposes of the group audit. A component auditor is a part of the engagement team for a group audit.

Scalability

- Applies to all group audits, regardless of size or complexity
  - Intended to be applied in the context of the nature and circumstances of each group audit

Update

- Introduces a risk-based approach to planning and performing a group audit
  - Requires use of professional judgment in determining the components for which procedures would be performed

Single Audits

- Adds 2 paragraphs to AU-C 935 around use of other auditors
  - Makes AU-C 600 not applicable in its entirety to Single Audits

Effective Date

- For audits of group financial statements for periods ending on or after December 15, 2026

Also Issued

- SQMS No. 3, Amendments to QM Sections 10, A Firm's System of Quality Management, and 20, Engagement Quality Reviews
  - Conforming amendments

GALASSO LEARNING SOLUTIONS

203

203

Let's Keep in Touch

- gls.advancecpe.com *(webinar)*
- gls.lcvista.com *(on-demand)*
- moneymattersfornonprofits.com
- galassolearningsolutions.com/subscribe
- linkedin.com/company/galassolearning

204

GALASSO
LEARNING SOLUTIONS

What Questions Do You Have?

Melisa F. Galasso
Chief Executive
Melisa@galassolearningsolutions.com
https://galassolearningsolutions.com

Content last reviewed: 4/29/24

205