The Demand for Audit and Other Assurance Services

Chapter 1
Sarbanes-Oxley Act

The Act established the Public Company Accounting Oversight Board.

It also requires auditors to report on the effectiveness of internal control over financial reporting.
Learning Objective 1

Describe auditing.
Auditing is the accumulation and evaluation of evidence about information to determine and report on the degree of correspondence between the information and established criteria.

Auditing should be done by a competent, independent person.
To do an audit, there must be information in a **verifiable form** and some standards (**criteria**) by which the auditor can evaluate the information.
Evidence is any information used by the auditor to determine whether the information being audited is stated in accordance with the established criteria.
Competent, Independent Person

- Competence
- Judgment and Experience
- Independence
- Evaluation of Evidence
- Proper Conclusion
To the Board of Directors and Stockholders of
ABC Corporation and Subsidiaries
Anywhere, USA
We have audited the accompanying consolidated balance sheets of ABC Corporation and Subsidiaries (the “Company”) as of December 31, 2010 and December 31, 2009, and the related consolidated statements of income, stockholders’ equity, and cash flows for each of the three years in the period ended December 31, 2010. Our audits also included the financial statement schedule listed in the Index at Item 15. These financial statements and financial statement schedule are the responsibility of the Company’s management. Our responsibility is to express an opinion on the financial statements and financial statement schedule based on our audits.
We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.
In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of ABC Corporation and Subsidiaries as of December 31, 2010 and December 31, 2009, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2010, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.
We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company’s internal control over financial reporting as of December 31, 2010, based on the criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 28, 2011, expressed an unqualified opinion on the Company’s internal control over financial reporting.
INTERNATIONAL CPA FIRM LLP
Anywhere, USA
February 28, 2011
Audit of a Tax Return Example

**FIGURE 1-1**
Audit of a Tax Return

- Competent, independent person
- Internal revenue agent
- Examines cancelled checks and other supporting records
- Accumulates and evaluates evidence
- Information
  - Federal tax returns filed by taxpayer
  - Determines correspondence
  - Established criteria
    - Internal Revenue Code and all interpretations
- Report on results
  - Report on tax deficiencies
Learning Objective 2

Distinguish between auditing and accounting.
Distinguish Between Auditing and Accounting

**Accounting** is the recording, classifying, and summarizing of economic events for the purpose of providing financial information used in decision making.

**Auditing** is determining whether recorded information properly reflects the economic events that occurred during the accounting period.
Learning Objective 3

Explain the importance of auditing in reducing information risk.
Economic Demand for Auditing

Demand Driver → Information risk

Auditing can have a significant effect on information risk.

What is meant by “Information risk”? 
Learning Objective 4

List the causes of information risk, and explain how this risk may be reduced.
Causes of Information Risk

- Remoteness of information
- Biases and motives of the provider
- Voluminous data
- Complex exchange transactions
Reducing Information Risk

- User verifies information

- User shares information risk with management

- Audited financial statements are provided
Relationships Among Auditors, Client, and External Users

- Client or audit committee hires auditor
- Auditor issues report relied upon by users to reduce information risk
- Provides capital
- Client provides financial statements to users

Client

Auditor

External Users
Learning Objective 5

Describe assurance services and distinguish audit services from other assurance and non-assurance services provided by CPAs.
Assurance Services

An independent professional service

Can be performed by CPAs or by a variety of other professionals
Attestation Services

- A type of assurance service
- CPA reports on the reliability of an assertion
- That is the responsibility of another party.
Attestation Services on Information Technology

*WebTrust* and *SysTrust* also meet the criteria of attestation service
Other Assurance Services

Most of the other assurance services that CPAs provide do not meet the formal definition of attestation services.

The CPA is not required to issue a written report.

The assurance does not have to be about the reliability of another party’s assertion about compliance with specified criteria.
Green Initiatives Bring Assurance Opportunities, Competition

Global interest has triggered a surge in reports.

80% of the Global Fortune 250 released environmental, social, and governance data.

Presented in standalone reports or integrated into annual financial reports.
Other Assurance Services

Examples

Assess risks of accumulation, distribution, and storage of digital information…

including

assessing security risks and related controls over data and other information stored electronically, including the adequacy of backup and off-site storage.
Other Assurance Services Examples

- Compliance with trading policies and procedures
- Compliance with entertainment royalty agreements
- ISO 900 certification
- Environmental audit
Assurance, Attestation, and Nonassurance Services

**FIGURE 1-3** Relationships Among Assurance Services, Attestation Services, and Nonassurance Services

**ASSURANCE SERVICES**
- Audits
- Reviews
- Internal Control over Financial Reporting
- Attestation Services on Information Technology and Other Attestation Services
- Other Assurance Services

**NONASSURANCE SERVICES**
- Other Management Consulting
- Accounting and Bookkeeping
- Certain Management Consulting
- Tax Services

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Learning Objective 6

Differentiate the three main types of audits.
Types of Audits

- Operational
- Compliance
- Financial Statement
### Operational Audit

#### Example
Evaluate computerized payroll system for efficiency and effectiveness

<table>
<thead>
<tr>
<th>Information</th>
<th>Number of records processed, costs of the department, and number of errors</th>
</tr>
</thead>
<tbody>
<tr>
<td>Established Criteria</td>
<td>Company standards for efficiency and effectiveness in payroll department</td>
</tr>
<tr>
<td>Available Evidence</td>
<td>Error reports, payroll records, and payroll processing costs</td>
</tr>
</tbody>
</table>
# Compliance Audit

<table>
<thead>
<tr>
<th>Example</th>
<th>Determine whether bank requirements for loan continuation have been met</th>
</tr>
</thead>
<tbody>
<tr>
<td>Information</td>
<td>Company records</td>
</tr>
<tr>
<td>Established Criteria</td>
<td>Loan agreement provisions</td>
</tr>
<tr>
<td>Available Evidence</td>
<td>Financial statements and calculations by the auditor</td>
</tr>
</tbody>
</table>
## Audit of Historical Financial Statements

<table>
<thead>
<tr>
<th>Example</th>
<th>Annual audit of Boeing’s financial statements</th>
</tr>
</thead>
<tbody>
<tr>
<td>Information</td>
<td>Boeing's financial statements</td>
</tr>
<tr>
<td>Established Criteria</td>
<td>Generally accepted accounting principles</td>
</tr>
<tr>
<td>Available Evidence</td>
<td>Documents, records, and outside sources of evidence</td>
</tr>
</tbody>
</table>
XBRL Electronic Data to Improve Financial Reporting

Extensible Business Reporting Language

Enables sorting and comparing of financial data

Public companies required to provide interactive financial statement data
Learning Objective 7

Identify the primary types of auditors.
Types of Auditors

- Independent certified public accounting firms
- Governmental general accounting office auditors
- Internal Revenue agents
- Internal auditors
Learning Objective 8

Describe the requirements for becoming a CPA.
Three Requirements for Becoming a CPA

- Educational requirement
- Uniform CPA examination requirement
- Experience requirement
CPA Examination Sections

Auditing and Attestation

Financial Accounting And Reporting

Business Environment and Concepts

Regulation
CBT-e: The CPA Exam Gets a Makeover

New content and skill specification outline revisions.

Exam structure changes and weighting of individual exam components.

Coverage of international auditing and financial reporting standards.
Three Requirements for Becoming a CPA

- **Educational Requirement**: Normally, an undergraduate or graduate degree with a major in accounting, including a minimum number of accounting credits. Most states now require 150 semester credit hours (225 quarter credits) for licensure as a CPA. Some states require fewer credits before taking the examination but require 150 semester credits before receiving the CPA certificate.

- **Uniform CPA Examination Requirement**: Computer-based examination offered at various testing centers. Examination sections are as follows:
  - Auditing and Attestation – 4 hours
  - Financial Accounting and Reporting – 4 hours
  - Regulation – 3 hours
  - Business Environment and Concepts – 3 hours
  Some states also require a separate ethics examination.

- **Experience Requirement**: Varies widely from no experience to 2 years, including auditing. Some states include experience working for governmental units or in internal auditing.
End of Chapter 1