Financial Statement and Compliance Audit Update

Focus on Recently Issued SASs, SSARs, and Current Yellow Book or Single Audit Hot Topics

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Learning Objectives

- Describe recent developments of the GAO, OMB, and AICPA
- Explain the impact of new technical, professional, and regulatory requirements
- Recall current accounting, reporting, and compliance issues faced by nonprofit entities
- Apply best practices to minimize noncompliance with hot topics in Yellow Book and Single Audits

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Recent Peer Review Results

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2024 Annual Report on Oversight

- Results per report dated April 2024
  - 21,600 peer review reports issued between 2021-2023
  - Pass Rates: Similar to "Unmodified"
    - 83% System Reviews and 85% Engagement Reviews
  - Pass with Deficiency: Similar to "Qualified"
    - 11% System Reviews and 10% Engagement Reviews
  - Fail Rates: Similar to "Adverse"
    - 6% System Reviews and 5% Engagement Reviews

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AICPA Peer Review Results 2023 Peer Review Year

- 12% of all engagements were nonconforming in 2023
  - 19% of all audit engagements were nonconforming

	2023	2022	2021
Compilations/Preparations with disclosures	7%	8%	7%
Compilations/Preparations omit disclosures	6%	7%	6%
Reviews	12%	12%	11%
Forecasts and Projections	13%	11%	12%
Single Audit	30%	32%	41%
Yellow Book and other governmental audits	18%	22%	29%
ERISA audits	22%	22%	28%
FDICIA	5%	32%	7%
Other audits	15%	20%	23%
AUP Engagements	10%	7%	8%
SOC Reports	16%	7%	13%
Other SSAE Engagements	23%	10%	9%

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Common Peer Review Issues with SSARSs Engagements

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Common Preparation Issues

1. Failure to disclose GAAP exceptions on face of financial statements, including the omission of the statement of cash flows
2. Failure to disclose the fact that substantially all disclosures have been omitted on the face of the financial statements or in selected notes
3. Engagement letter required elements missing or not signed by both parties
4. Failure to include a "no assurance is provided" statement on the financial statements

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Common Special Purpose Framework F/S Issues

1. F/S not appropriately titled
2. F/S not include appropriate classifications
3. Failure to have adequate disclosures

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Common F/S Reporting Issues

1. Failure to disclose date through which subsequent events were evaluated
2. Failure to adopt the latest professional standards, such as CECL
3. L-T debt not properly classified and disclosed, including maturity schedule
4. Related party transactions not disclosed
5. Significant estimates not disclosed
6. Improper classification in SOCF or omitting it

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Common Compilation Issues

1. Engagement letter required elements missing or not signed by both parties
2. Not updated for the current pronouncements
3. Not addressing supplementary information
4. Inappropriate report date
5. Failure to mention omission of substantially all disclosures
6. Failure to report on all periods presented
7. Inappropriate addressing of the use of a special purpose framework that differs from GAAP

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Common Review Issues

1. Basic reporting required elements omitted
   – E.g., inappropriate titles, supplementary information, no report headings, not all periods addressed
2. Management representation letter dated incorrectly or did not cover the appropriate periods
3. Engagement letter required elements missing or not signed by both parties
4. Analytical procedure expectations not documented or compared to final results

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Analytical Procedures Defined

- Evaluations of financial information through analysis of plausible relationships among both financial and nonfinancial data
- Such investigation, as necessary, of identified fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount

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Focus on Expectations

- Accountant's plausible predictions of recorded accounts or ratios
- Any significant difference between expectations and actual indicates a possible misstatement
- Seek to obtain explanations that are reasonable and consistent in light of other procedures
  - And accountant's knowledge of entity, industry, and environment
  - May involve follow-up inquiry with management

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Sources of Expectations

- Prior-period information adjusted for expected changes
- Management's budgets and forecasts
- Industry data
- Nonfinancial data (such as square footage)

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Pulse Check

Do you think that materiality applies in a review engagement when reviewing the results of analytical procedures?

A. Yes.

B. No.

C. Uncertain.

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Concept of Precision

- A judgmental measure of how close the expectation is to the correct amount
  - The more precise the expectation, generally the more effective the procedure in providing assurance in detecting unexpected differences which may be the result of misstatement
- A way to address areas believed to have increased risks of material misstatement
- Similar in concept to “performance materiality” on an audit, except not required to be a quantified amount less than planning materiality

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Forming an Expectation

- Understanding of entity and industry
  - Any changes in business?
  - Any changes in accounting principles or practices?
  - Are industry economic trends relevant to entity?

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Trend Analysis

- Most appropriate for predictable and stable amounts
  - Consider appropriate level of disaggregation to increase precision
- P/Y amounts adjusted for expected changes can increase precision
  - Important when assumptions underlying prior period amounts are no longer valid
  - E.g., accounting for changing interest rates, inflation

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Ratio Analysis

- May compare relationship of two accounts
  - E.g., current ratio, A/R to sales
- May compare relationship with nonfinancial data
  - E.g., revenue per order, sales per square foot
- May compare to industry when operating factors are comparable (which may be difficult to discern)
  - E.g., gross profit
- May include "common size" analysis
  - E.g., selling costs and other major expense categories to sales

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Reasonableness Testing

- Uses information to develop an explicit prediction of the account balance or relationship
- Obtain information about multiple factors impacting the account being tested
  - E.g., number of employees hired and terminated, timing of pay adjustments, effect of vacation and sick days, etc. for payroll expense
  - E.g., number of units sold, unit price by product line, different pricing structures, etc. for sales

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Handling Differences Outside of Expectation

- Permits acceptance of differences up to a particular threshold without further explanation
- Difference may be due to:
  - Misstatement
  - Reliability of the data
  - Inherent factors, such as subjectivity of the account
- Inquire of management if the reason for a difference is unknown
- Consider the cost-benefit of creating a more precise expectation

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Consider the Plausibility of Difference Explanations

- Consistency with explanations contained in reports issued by management or those charged with governance
  - E.g., budget vs. actual
- Consistency with minutes of those charged with governance meetings
- Unusual transactions or events in prior or current period
- Consistency with inquiry of nonfinancial personnel

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Documentation - Analytics

- Expectation and factors considered in its development
- Results of comparison to recorded amounts or ratios developed from recorded amounts
- Any inquiries of management and other procedures performed to investigate differences
  - Basis for determination as to whether responses appear reasonable or whether a possible misstatement exists

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Recent SSARS

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SSARS NO. 27
Consulting Engagements

- Preparing F/S as part of a consulting services engagement is not required to apply AR-C *Section 70, Preparation of Financial Statements*
  - Must be performed in accordance with CS Section 100, *Consulting Services: Definitions and Standards*
- Effective for the preparation of financial statements for the periods ending on or after December 15, 2026
  - Early implementation permitted

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Why Does SSARS No. 27 Matter?

- The CS engagements are not included in the population subject to peer review
- Applies when CFO or controllership services are performed under consulting standards
- General professional standards of professional competence, due professional care, planning and supervision, and sufficient relevant data apply to consulting services

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Common Peer Review Issues – Audit Documentation

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Most Common Problem- Lack of Adequate Documentation

- If it's not documented, it wasn't finished!
- Documentation should be sufficiently detailed to give experienced accountants who were not previously involved in the engagement a clear understanding of the work performed, the evidence obtained, and the conclusions reached
  - This includes significant professional judgments made in reaching conclusions on significant matters arising during the engagement

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Key Point About Audit Documentation

- Lack of documentation is an omitted procedure!
  - No amount of oral explanation can serve as a substitute
- Failure to comply with documentation standards may require you to perform additional work under AU-C 585, *Consideration of Omitted Procedures After the Report Release Date*

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Common Peer Review Issues – Evidence

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Common Audit Issues – Evidence

1. Relying too heavily on inquiry procedures as evidence, without corroboration or support
2. Not properly identifying, evaluating, and responding to fraud risk indicators
3. Failure to document significant findings or issues, including unusual matters and their disposition

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AU-C Section 500, Audit Evidence Objective

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

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Key Definitions

- **Sufficient audit evidence** – Measure of quantity affected by assessed risk of material misstatement and evidence quality
- **Appropriate audit evidence** – Measure of quality, including relevance and reliability in supporting conclusions

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Key Concepts

- **Reliability of evidence** – Depends on the nature and source, as well as circumstances under which evidence was obtained
- **Persuasiveness** – Relates to obtaining appropriate audit evidence that is sufficient to draw conclusions
  - More persuasive audit evidence is needed to respond to significant risks

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Assessment of Accuracy and Completeness of Information

- Consider the design and implementation of relevant controls
- Tests of controls **may** be necessary when the auditor intends to use information generated internally from the entity's general and subsidiary ledgers as audit evidence

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Authenticating Evidence

- The auditor is not responsible for "authenticating" documents or detecting all fraud
- However, if conditions cause the auditor to question authenticity, additional procedures may be necessary
  - E.g., external confirmation, engaging a specialist, etc.

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Management Bias

- Information with a higher susceptibility to management bias is generally less reliable
  - Information generated from internal sources are more susceptible to bias
- Bias may exist in the development of the information itself or due to interpretation of the information by the entity
- Bias may be in the form of selecting information from an external source known to be favorable to management's assertion

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Evaluating Audit Evidence From External Information Sources

- The nature, authority, competence, reputation, past experiences, objectivity, general market acceptance, nature of any disclaimers, etc.
- Reporting entity management's controls over information reliability
- The external source's processes, techniques, and assumptions
- Nature and extent of any disclaimers or other restrictive language

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Management's Specialist Defined

- Management's specialist is defined as an individual or organization expertise in a field other than accounting or auditing, whose work in that field is used by the entity to assist in preparing the financial statements
  - e.g., actuarial calculations, valuations, pricing services, or engineering data

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Information About Competence, Capabilities, and Objectivity

- Personal experience with previous work of that specialist
- Discussions with that specialist
- Discussions with other who are familiar with that specialist's work
- Knowledge of that specialist's qualifications, membership in a professional body or industry association, license to practice, or other forms of external recognition

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Auditor's External Specialist

- The auditor is responsible for obtaining an understanding of any significant assumptions and methods applied and evaluating the appropriateness and reasonableness of application
- External resource is subject to the firm's quality management system
  - Similar to consultants or component auditors

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Auditor Bias

- **Availability bias** – A tendency to place more weight on events or experiences that immediately come to mind or are readily available.
- **Confirmation bias** – A tendency to place more weight on information that corroborates an existing belief.
- **Overconfidence bias** – A tendency to overestimate one's own ability to make accurate assessments of risk or other judgements or decisions.
- **Anchoring bias** – A tendency to use an initial piece of information as an anchor against which subsequent information is inadequately assessed.
- **Automation bias** – A tendency to favor output generated from automated systems.

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Common Peer Review Issues – Identifying and Assessing Risk of Material Misstatement

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Common Audit Issues – Risk Assessment

1. Not properly identifying, evaluating, and responding to various engagement risks
   – Including failure to assess risk at the relevant assertion level
2. Not altering nature, timing, and extent of procedures based on risk and other evidence
3. Failure to properly document consideration of going concern pervasive risk when readily apparent

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Risk-Based Auditing

Goal: Reduce Audit Risk
to Acceptably Low Level

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Audit Risk Formula

Auditor's Gut Call — Inherent Risk

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Design and **Operating Effectiveness** of Reporting Entity's Internal Control — Control Risk

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Substantive Testing — Detection Risk

→ Audit Risk — Risk the Auditor Unknowingly Gives the Wrong Audit Opinion

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Benefits of Risk-Based Focus

- Leverages knowledge and experience gained in prior audits of same or similar reporting entities
- Brings entire engagement team into understanding "why"
- Alters nature, timing, and extent of procedures to be commensurate with risk

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Risk Assessment Activities

1. Determine planning and performance materiality
2. Understand the entity and operating environment
3. Perform preliminary analytical procedures
4. Understand and evaluate the design and implementation of internal control over financial reporting

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Risk Assessment Activities

6. Consider a control reliance strategy
7. Identify and evaluate fraud risk
8. Assess risk of material misstatement at the overall financial statement and relevant assertion level
9. Hold an engagement team discussion
10. Link risk to the detailed audit plan

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Key Clarifications

- Scale risk and response to the nature, size, and complexity of the audited entity
- An understanding of the applicable financial reporting framework, accounting policy elections, and changes therein is a part of being able to identify risk
- Leverage technology to improve the quality of evidence and efficiency
- Always exercise professional skepticism

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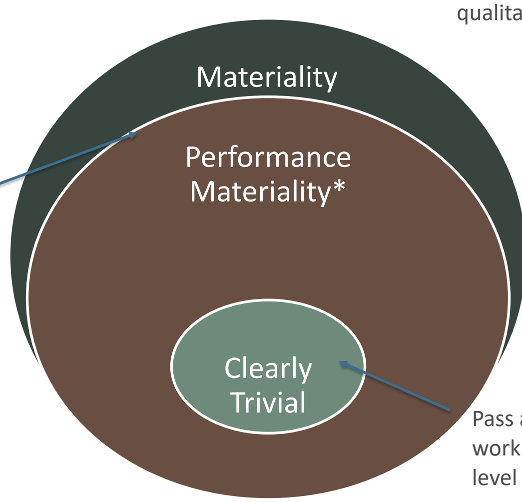
What would cause someone to make a different economic choice (quantitatively or qualitatively)?

The maximum error willing to accept in a population, used for:
- Scopes
- Samples
- Acceptance thresholds

* Also called Tolerable Misstatement



Pass at the workpaper level

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Procedures to Assess Overall Risk and Identify Relevant Assertions

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Critical Elements of Entity and Environment That Impact Risk

- Industry, regulatory, and other external factors
- Nature of the entity, including selection and application of accounting principles and reason for changes
- Measurement and review of financial performance
- Objectives and strategies, and the related business risks

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Factors That May Increase Risk for the F/S as a Whole

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Understanding the "System" of Internal Controls

- Comprised of five interrelated components, which are embedded with individual controls that can be segregated between "indirect" and "direct" controls
  - Consistent with the COSO *Internal Control – Integrated Framework*

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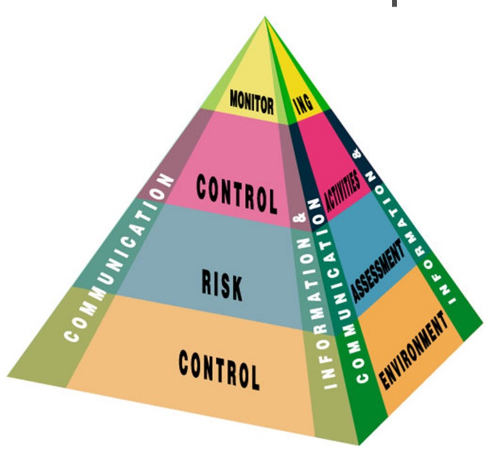
5 Internal Control Components



Source: Based on the 2013 COSO *Integrated Framework*

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Five Components – 17 Principles

1. Control Environment	1. Demonstrate commitment to integrity and ethical values. 2. Exercise oversight responsibility. 3. Establish structure, authority and responsibility. 4. Demonstrate commitment to competence. 5. Enforce accountability.
2. Risk Assessment	6. Specify suitable objectives. 7. Identify and analyze risk. 8. Assess fraud risk. 9. Identify and analyze significant changes.
3. Control Activities	10. Select and develop control activities. 11. Select and develop general controls over technology. 12. Deploys through policies and procedures.
4. Information and Communication	13. Use relevant information. 14. Communicate internally. 15. Communicate externally.
5. Monitoring	16. Conduct ongoing and/or separate evaluations. 17. Evaluate and communicate deficiencies.

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Risk Assessment Summary

- Describe overall risks and your planned responses.
  - Examples of overall risks include weaknesses in the control environment, changes in management, going concern considerations, motivation by management to fraudulently misstate the financial statements, etc.
  - Responses may include consideration of staffing, increasing the level of supervision, changing the timing of procedures, etc.

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Inherent Risk Factors Defined

- Characteristics that affect the susceptibility to misstatement before consideration of controls
- May be quantitative or qualitative
- e.g., complexity subjectivity, change, uncertainty, susceptibility to management bias or fraud risk

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Relevant Assertion Defined

Both of the following must be true:

1. There is a reasonable possibility of a misstatement occurring (likelihood)
   – If likelihood is remote, then there is not a relevant assertion to address
2. There is a reasonable possibility of the misstatement being material (magnitude)

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Relevant Assertion-Level Risk

1. Existence or occurrence
2. Completeness
3. Rights and obligations
4. Accuracy, valuation or allocation
5. Understandability, classification, presentation, and disclosure
6. Cutoff

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Preliminary Assessment of Inherent Risk

Note: Based on auditor's professional judgment PRIOR to evaluating the design and implementation of control activities and information processing activities relevant to "significant" accounts, classes of transaction, and disclosures.

Low Possible/Trivial → Moderate Possible/Significant → High Possible/Material → Significant Risk Probable/Material

- Assertion is "on the spectrum" of risk if a relevant assertion
- Categorize based on likelihood and magnitude of known or likely fraud and error

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Significant Class of Transactions, Account Balance, or Disclosure

- There is one or more relevant assertions meriting a planned audit response
  - Document where initially on the spectrum of risk
- Triggers the need to consider the design and implementation of related information-processing and control activities
  - Including the use of information technology
- Finalize a planned audit response commensurate with assessed risk

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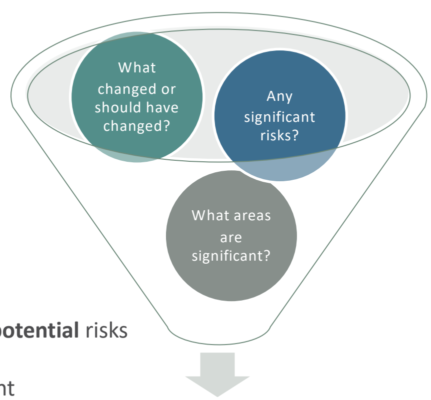

Purpose:
To identify **potential** risks of material misstatement

Preliminary Analytic Review

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Linkage of Audit Risk to Detailed Audit Plan

Risk of material misstatement is driven by inherent risk if control risk is left at high

If detection risk is low, then more persuasive audit evidence required

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Pulse Check

What statement best describes the purpose of the risk assessment summary?

A. To detail the specific procedures to be performed for each audit area.

B. To provide an executive summary overview of identified risk, level of severity, and general planned responses.

C. To document sufficient and appropriate audit evidence to support conclusions.

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Engagement Team Discussion

- Key engagement team members, including partner, agree on planned audit approach
  - Communicate significant matters to those not in attendance
- Exchange of ideas or brainstorming
  - How and where fraud or error may occur in F/S and resulting risk assessment
  - Determine whether additional information or follow-up is necessary to form an appropriate planned response
- Opportunity for more experienced team members to share insights and concur on critical judgements and decisions

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Final Analytics

- AU-C Section 520, *Analytical Procedures*
- Stand back" to evaluate the completeness of significant accounts/classes/disclosures
  - Corroborate audit evidence obtained
- Assists with overall conclusions on which F/S audit opinion based

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Common Peer Review Issues – Internal Control Responsibilities

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Common Audit Issues – Internal Controls

1. Inadequate documentation of evaluation of design of internal controls for F/S audits
   – Including the role of IT
2. Relying on client's internal controls without adequate testing of "operating effectiveness"
3. Not properly documenting rationale for categorization of internal control deficiencies

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Importance of Evaluating Design & Implementation

- Understanding **how** management has set up its system of internal control helps the auditor to form a view about where the auditor's attention should be placed
  - Helps determine what constitutes a significant account, class of transaction, or disclosure and where significant risks of material misstatement may occur
  - Assists in designing tests of operating effectiveness, when applicable
  - Impacts design of substantive procedures

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The Design and Implementation Evaluation Process

- Design – Control, individually or in aggregate, capable of preventing, or detecting and correcting, material misstatements, whether due to fraud or error
  - Understand how system is designed to function
- Implementation – Control exists and entity is using it

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Controls Defined

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

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Presumptively Relevant Controls

1. Controls that address a risk that is determined to be a significant risk
2. Controls over journal entries and other adjustments
3. Controls for which the auditor plans to test operating effectiveness in determining the nature, timing, and extent of substantive procedures
4. Should include controls that address risks for which substantive procedures alone do not provide sufficient appropriate audit evidence
5. Other controls that, based on the auditor's professional judgment, the auditor considers are appropriate to enable the auditor to meet the objectives with respect to risks at the assertion level

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Other Controls That **May** Require Assessment

1. Controls that address risks assessed as higher on the spectrum of inherent risk but have not been determined to be a significant risk
2. Controls related to reconciling detailed records to the general ledger
3. Controls related to accounting estimates
4. Complementary user entity controls, if using a service organization

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Key Point About Scope of Understanding

- The auditor is not required to identify and evaluate all information-processing controls related to the entity's policies that define the flows of transactions and other aspects of the entity's information-processing activities for the significant classes of transactions, account balances, and disclosures
  - Or to every assertion relevant to them
- Identified controls are sometimes referred to by auditors as "relevant" or "key" controls

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Pulse Check

Do you feel that identified internal control deficiencies should impact risk of material misstatement assessments on audits?

A. Yes.

B. No.

C. Uncertain.

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Impact of Identified Deficiencies

Note: May be a deficiency in design, implementation, or operating effectiveness

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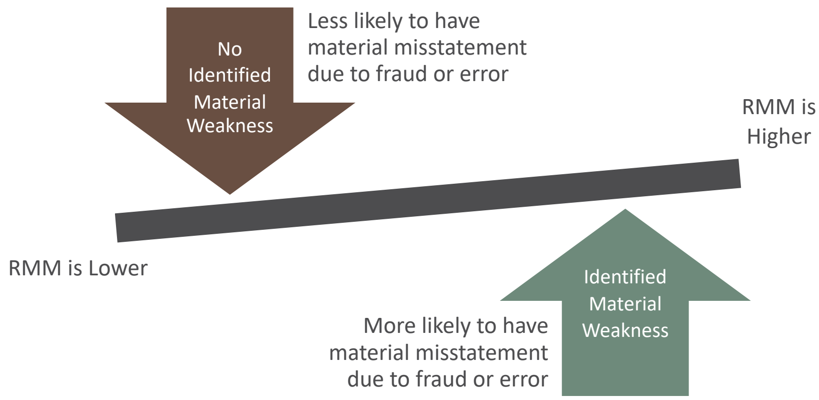
Impact of Design of Internal Control on Risk Assessment



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Verifying Implementation vs. Operating Effectiveness

Implementation

- Controls Exist and Are In Use

Operating Effectiveness

- Consistently Applied in a Quality Way

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When to Reduce Control Risk

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<u>When Effective</u>

- Relevant controls well designed
- Required by regulatory requirements
- Substantive testing alone not adequate

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<u>When Efficient</u>

- Fewer hours will be spent testing controls for consistent application over audit period:
  - Compared to substantive testing alone

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Discussion Question

In what circumstances could you perceive a control reliance strategy being necessary in order to gather sufficient appropriate evidence in today's environment, even for nonpublic entities?

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Select Highlights of PCAOB Spotlight: Staff Update on 2023 Inspection Activities

Issued August 2024

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Identifying Relevant Controls

- **Journal entries**: Risk that the same individual could prepare and post journal entries in the general ledger system without approval
- **Underlying data files**: Controls over the accuracy and completeness of a calculation file that was used in the performance of a “key control”

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Journal Entry Testing

- Sufficiently test the completeness of the population that was used to make selections for journal entry testing
- Support rationale used for identification and selection of journal entries for testing
- Support rationale for limiting its testing to only certain journal entries that met its identified fraud criteria

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Evaluating Management Review Controls

- Verifying that a review was "signed off" provides little or no evidence by itself about the control's effectiveness
- Consideration should include evaluating the precision of management review controls
- Identify procedures that the control owner performed to assess the reasonableness of assumptions used and conformity of methods with the applicable financial reporting framework

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Common Peer Review Issues – Satisfying Detection Risk

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Detection Risk

- Risk that the auditor's procedures will **not** detect a material misstatement that occurs
- The higher the detection risk the auditor willing to accept
  - The less rigorous the nature, timing, and extent of audit procedures
- Satisfied through tests of details, substantive analytical procedures, or combination of both

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Must Obtain Sufficient Appropriate Audit Evidence

Nature, Timing, and Extent of Audit Procedures
Varies Depending on Three Factors:

- Assessed Risk of Material Misstatement
- Materiality and Performance Materiality
- Other Procedures Performed to Address Same Risk

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Risk of Material Misstatement – Example Combinations

IR	CR	RMM	DR
H	**H**	H	Low
H	M	H	Low
H	**L**	M	Moderate
M	**H**	M	Moderate
M	M	L	High
L	**H**	L	High

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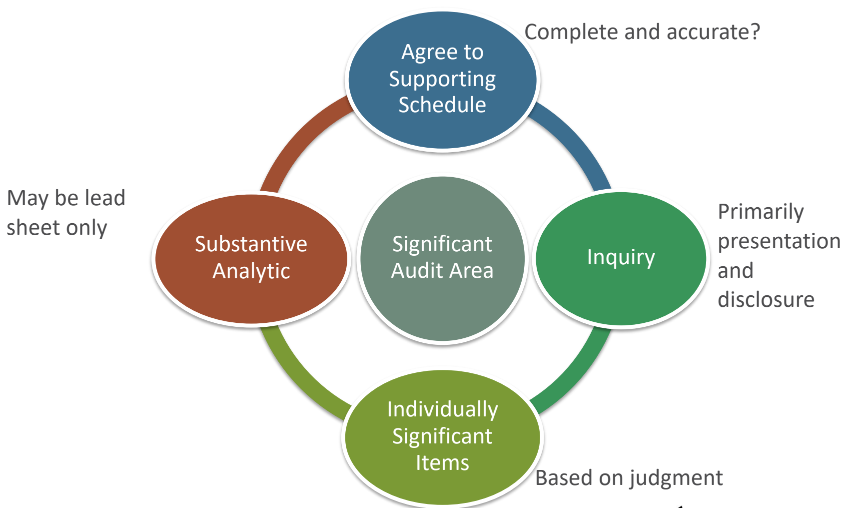
Four “Basic” Food Groups



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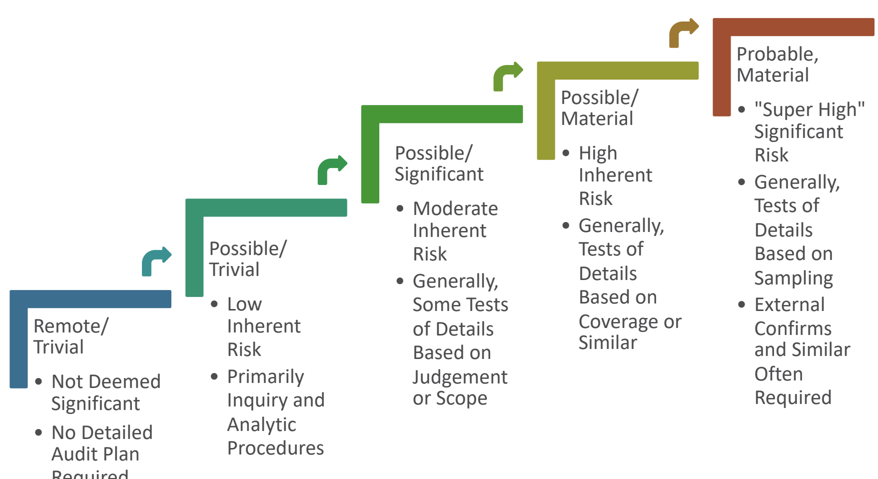
Inherent Risk Scalability – One Example Approach



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Common Audit Issues – Analytical Procedures

1. Failure to document expectations when performing analytical procedures or compare to final results

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How to Strengthen a Substantive Analytical Procedure

- Increase disaggregation of data used to develop expectation
- Use more persuasive source of data for expectation
- Lower the acceptance threshold for any difference
- Combine with other analytics or tests of details

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Common Audit Issues – Other Common Evidence Issues

1. Failure to observe the physical inventory count, when material
2. Failure to confirm significant receivables, or document how presumption overcome
3. Use of outdated practice aids or those inappropriate for the type of industry

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Application of Performance Materiality to Extent of Testing

Zero — Full PM/TM

- Scopes for individually significant items
- Acceptance thresholds for substantive analytics

Note: Also influences sample size calculations:

Population/Tolerable Misstatement x Risk Factor

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Common Audit Issues – Sampling

1. Failure to adequately document sample size determination, methodology
2. Failure to project results of sampling to population

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Example Confidence Factors

Risk of Incorrect Acceptance	Confidence of Sample	Confidence Factor
50%	50%	0.7
37%	63%	1.0
35%	65%	1.05
30%	70%	1.21
25%	75%	1.39
20%	80%	1.61
15%	85%	1.9
10%	90%	2.31
5%	95%	3.0

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Increased Focus on Disclosures

- Fraud discussion should address the risk of omitting, obscuring, or misstating disclosures either required or needed to achieve fair presentation
- Assess relevant assertion risk of material misstatement for significant disclosures
  - Quantitatively or qualitatively
- Increased focus on internal controls over disclosure information, regardless of source
- Agree or reconcile disclosure information
- Accumulate misstatements in disclosures that are more than trivial

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Common Peer Review Issues – Auditing Areas of Accounting Uncertainty

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Common Audit Issues – Other Common Evidence Issues

1. Failure to document procedures performed to obtain assurance about fair value measurements

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Key Definitions

- **Accounting estimate** – A monetary amount, including amounts in disclosures, where measurement is subject to estimation uncertainty.
  - Includes fair value measurements.
- **Estimation uncertainty** – Susceptibility to an inherent lack of precision in measurement, which may exist even when the valuation method and data are well-defined.

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Common Further Audit Procedures

- Review the outcome of previous accounting estimates
  - Or, when applicable, their subsequent re-estimation
  - A retrospective review over several periods may be appropriate when the outcome of an estimate is resolved over a longer period or when a history of outcomes provides meaningful information or evidence of a trend

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Common Further Audit Procedures

- Obtain audit evidence from events occurring up to the auditor's report date
  - Considering changes in circumstances and other relevant conditions

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Key Considerations When Testing Management's Estimate

- Whether the method selected is appropriate in the context of the applicable framework
  - If applicable, changes from the method used in prior periods are appropriate
- Whether the integrity of the significant assumptions and the reliability of underlying data input into the method has been maintained
- Whether judgments made give rise to indicators of possible management bias
- Calculations are mathematically accurate

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Focus on Group Audits Per SAS No. 149

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Special Considerations – Audits of Group F/S

- Provides for a more risk-based approach
- Includes the work of component auditors and audits of referred-to auditors
- Effective for financial statement audit periods ending on or after December 15, 2026
  - Earlier implementation permitted

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Group Defined by SAS No. 149

- A reporting entity for which group financial statements are prepared
- Group F/S include the financial information of more than one entity or business unit through a consolidation process, including:
  - Equity method investment
  - Cost method investment, when other auditor reports constitute a major element of evidence
  - Entity where separate function, location, product/service is managed, and financial results separately reported, to head office

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Pulse Check

Do you think that equity method investments should be included in group audit special considerations?

A. Yes.

B. No.

C. Uncertain.

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Can Concepts Apply to Other Audits?

- Adapted to the circumstances, this guidance may be useful in audits that are not group financial statements
  - E.g., using another auditor to observe inventory of inspect physical fixed assets at a remote location

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Two Reporting Options

1. Being involved in the work of component auditors
   - Part of the engagement team and subject to quality management
2. Making reference to the audit of a component auditor (called the referred-to auditor)
   - Not a part of the engagement team, but there are required minimum procedures to use the reference option

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Understanding the Group, Its Components, and Their Environments

- Enhance its understanding of the group, its components, and their environments
  - Including group-wide controls
- Obtain an understanding of the consolidation process
  - Including the instructions issued by group management to components
- Should be sufficient to identify significant components

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Consolidation

- Evaluate the appropriateness, completeness, and accuracy of the consolidation process to respond to the assessed risks of material misstatement
  – Including consolidation adjustments and reclassifications
- Evaluate whether all components have been included in the group F/S

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Adjustment Considerations

Adjustments should be made the component financial statements when:

1. Not applying the same accounting policies of the group F/S
2. The component has a different reporting period-end

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Subsequent Events Considerations

- Perform procedures designed to identify events at those components that occur between the dates of the financial information of the components and the date of the auditor's report on the group F/S
  - May require adjustment to, or disclosure in, the group F/S

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Materiality Considerations

- The group engagement team should establish:
  - Group materiality
  - Group performance materiality and clearly trivial
- Except for referred-to auditors, group engagement team responsible for component materiality:
  - Required to be lower than group materiality to ensure aggregate of uncorrected and undetected misstatements acceptable
- Determine whether a lower performance materiality is required for specific accounts, classes of transactions, or disclosures

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Common Peer Review Issues – Audit Report and By-Product Communications

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Common Audit Issues – Report

1. Failure to reference or report on supplemental information or required supplemental information
2. Failure to use appropriate titles for special purpose framework financial statements
3. Failure to reference all time periods covered by the financial statements in auditor's report

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Common Audit Issues – By-Product Communications

- Adequately communicate and/or document required communications with those charged with governance

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Common Management Representation Letter Issues

1. Failure to update the letter to include all representations required under currently applicable standards
2. Inappropriate date of the letter
3. Not covering all financial statement periods
4. Failure to include appropriate wording concerning consultation with an attorney
   - Failure to modify management representation letter when client has not consulted legal counsel

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Common Peer Review Issues with Quality Management System

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Quality Management System Issues

- Failure to devote sufficient resources to support quality management policies and procedures
- Failure to ensure firm personnel complete the appropriate CPE
- Failure to perform Engagement Quality Reviews when required by firm policies
- Failure to properly complete practice aids as required by firm policies
- Failure to update quality control/management documents for the results of monitoring

An Integrated Approach

Source: AICPA

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Pulse Check

Do you think a firm's system of internal controls over quality management should be designed consistent with COSO?

A. Yes.

B. No.

C. Uncertain.

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Effective Dates

1. By December 15, 2025 – Redesign the firm's system of quality management
2. By December 15, 2026 – Perform first annual evaluation of system
3. Perform new Engagement Quality Reviews when required by firm policy as follows:
   – Calendar-year 2026 F/S audits and reviews
   – Other engagements that begin on or after 12/15/25
4. SAS/SSARs effective with calendar-year 2026 audits/reviews

Note: Early adoption is permitted as a set.

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New Risk Assessment Process

1. Establish quality objectives
   – Some are required and some are necessary
2. Identify and assess "quality risks"
3. Design and implement responses
4. Establish policies and procedures for identifying additions or modifications

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More on "Quality Risks"

- Understand how relevant conditions, events, circumstances, actions, or inactions may adversely affect achievement of quality control objectives
- Reasonable possibility of both
  - Occurring and
  - Adversely affecting the achievement of quality objective(s) either individually or in the aggregate with other risks

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Prepare Documentation

1. Adapt documentation to the firm's complexity
2. Ensure documentation is sufficient to:
   - Support a consistent understanding amongst personnel, including their roles and responsibilities
   - Support consistent implementation and operating effectiveness of planned responses

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Establish a Process for Ongoing Monitoring

- Adapt monitoring and remediation processes commensurate with risk
  - A system of quality control is individual to each firm
- At least annually, evaluate whether the firm's system of quality management provides reasonable assurance of meeting objectives
  - Beginning no later than one year from 12/15/2025

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Updates to Professional Standards

- *SAS No. 146 - Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*
- *SSARS No. 26 – Quality Management for an Engagement Conducted in Accordance With Statements on Standards for Accounting and Review Services*
- *SSAE No. 23 - Amendments to the Attestation Standards for Consistency With the Issuance of AICPA Standards on Quality Management*
- Effective for engagements for periods beginning on or after December 15, 2025

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Primary Goals of Updates

- Encourage proactive management of quality at the engagement level
- Emphasize the importance of the exercise of professional skepticism
- Enhance the documentation of the accountant's judgments
- Reinforce the need for robust communications during the engagement

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Engagement Team Defined

- All partners and staff performing the audit/ attestation engagement and any other individuals who perform attestation procedures on the engagement
  - Excludes a practitioner's external specialist (See AU-C Section 620)
  - Excludes internal auditors who provide direct assistance on an engagement (See AU-C Section 610)

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Engagement Partner Example Responsibilities

1. Be satisfied that firm's policies and procedures for engagement acceptance and continuance have been followed, including conclusions about management's integrity
2. Members of the engagement team have the appropriate competence and capabilities, including sufficient time
3. Determine sufficient appropriate resources are available in a timely manner, considering any changes that may arise during the engagement

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Do Not Accept Engagement If…

- Reason to believe that relevant ethical requirement, including independence will not be satisfied
- Information needed to perform the engagement is likely to be unavailable or unreliable
- Cause to doubt management's integrity, such that it is likely to affect engagement performance

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Pulse Check

Do you think that CPA Firms should be more willing to not accept or continue with certain engagements in order to promote high quality audit and attest engagements?

A. Yes.

B. No.

C. Uncertain.

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Engagement Partner Example Responsibilities

1. Emphasize culture of expected behavior, including the importance of professional skepticism
2. Be sufficiently and appropriately involved throughout the engagement to have a basis for determining that significant judgments made (and conclusions reached) are appropriate given the nature and circumstances

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Engagement Quality Review Defined

- An objective evaluation of the significant judgments made by the engagement team and the conclusions reached thereon performed by the engagement quality reviewer and completed before the engagement report is released
- For engagements where EQR is required, the report should not be released until completed

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Inspection Defined

- Inspection is an evaluation of the adequacy of aspects of the firm's quality management policies and procedures, its personnel's understanding of those policies and procedures, and the extent of the firm's compliance with them

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Common Peer Review Issues with Code of Professional Conduct

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Executive or Employee Recruiting

- Approved by PEEC in November 2024
- Effective 1/1/26
  - Early implementation permitted

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Assistance That Can Not Be Safeguarded

- Hires or terminates an attest client's employees
- Advises on the specific terms of employment, renumeration, or related benefits of a particular candidate for a key position
- Searches for or seeks out candidates for key positions
- Undertakes reference checks of prospective candidates for a key position

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Assistance That Can Not Be Safeguarded

- Recommends to the attest client only one candidate for consideration for a key position
- Ranks candidates for a key position whether or not using the attest client's criteria
- Negotiates with the candidate on behalf of the attest client
- Commits the attest client to employee compensation or benefit arrangements

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2024 Yellow Book

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Government Auditing Standards

- Also called "Yellow Book" or Generally Accepted Government Auditing Standards (GAGAS)
- Issued by the Comptroller General of the United States of the U.S. Government Accountability Office (GAO)
- Last issued 2024
- Supplements AICPA, PCAOB, or IAASB standards

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Organization of 2024 *Government Auditing Standards*

	Financial Audits	Attestation Engagements	Performance Audits
CH 1—Foundation and Principles	✓	✓	✓
CH 2—General Requirements for Compliance	✓	✓	✓
CH 3—Ethics, Independence, and Professional Judgement	✓	✓	✓
CH 4—Competence and Continuing Professional Education	✓	✓	✓
CH 5—**Quality Management, Engagement Quality Reviews, and Peer Review**	✓	✓	✓

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Supplemental Requirements – For Audit Organizations Exempt

- 5.55c – Engagement Performance
  - If an engagement is terminated before completion and report is not issued, document the results of the work to date and why engagement was terminated
- 5.55d – Engagement Performance
  - If auditors change the engagement objectives during the engagement, document the revised engagement objectives and the reasons for the changes
- 5.74c – Resources
  - Ensure auditors who are performing work in accordance with GAGAS meet the CPE requirements

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Organization of 2024 *Government Auditing Standards*

	Financial Audits	Attestation Engagements	Performance Audits
CH 6—Standards for Financial Audits	✓		
Ch 7 – Standards for Attestation Engagements and Reviews of Financial Statements		✓	
CH 8—Fieldwork Standards for Performance Audits			✓
CH 9—Reporting Standards for Performance Audits			✓

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Effective Date

- Effective for financial audits, attestation engagements, and reviews of financial statements for periods beginning on or after December 15, 2025
- Effective for performance audits beginning on or after December 15, 2025
- Design and implement system of quality management by December 15, 2025
  - Evaluate the system by December 15, 2026
- Early implementation permitted

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2024 Uniform Guidance Highlights of Impact & Applicability

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Uniform Guidance Organization

The organization of the Uniform Guidance for Federal Awards					
Subpart A - Acronyms and Definitions (§200.00 - §200.99)	**Subpart B - General Provisions (§200.100 - §200.113)**	**Subpart C - Pre-Federal Award Requirements and Contents of Federal Awards (§200.200 - §200.211)**	**Subpart D - Post Federal Award Requirements (§200.300 - §200.345)**	**Subpart E - Cost Principles (§200.400 - §200.475)**	**Subpart F - Audit Requirements (§200.500 - §200.521)**
Contains acronyms and definitions used in administrative requirements, cost principles, and audit requirements.	Contains some broad overall guidance (e.g., effective dates)	Contains administrative requirements		Contains cost principles	Contains audit requirements

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Effective Date of New Uniform Guidance

- Applicable to federal awards issued on or after October 1, 2024
  - Federal agencies may elect to early adopt any provision other than Single Audit and major program threshold requirements
  - The effective date for "existing" awards will depend

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Federal Agency Adoption

- Required to implement 2024 UG through the terms and conditions of new awards issued on or after 10/1/2024
- Encouraged to apply 2024 UG to award amendments entered into on or after 10/2/2024
- Encouraged to apply 2024 UG to existing awards that will extend into FY 2025 or beyond

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Discussion Question

1. If auditing an entity with a 6/30/25 year end with awards both before and after 10/1/2024, how should you determine whether to use the old or new UG rules for testing compliance?
2. What if a 12/24 award amendment is silent on whether 2024 UG applies?

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When Applicability of 2024 UG is Unclear

- Generally, if an award amendment is silent, the assumption is that prior UG applies
- If an award amendment is silent, but the agency links to a posing on its website stating that 2024 UG applies in its standard Terms and Conditions, then discuss the applicability with the federal agency to discern intent

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Entity Only Receives Funding from Pass-Through Entities (PTEs)

- PTEs are required to amend any subawards already issued when a federal agency amends an existing award to apply the 2024 UG
- Even if a subaward is executed on or after 10/1/2024, PTEs may not apply 2024 UG to a subaward if the federal agency has not applied the 2024 UG

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Non-federal Entity Terminology Clarified

- The term “recipient or subrecipient” replaces “non-federal entity”
  - Except when non-federal entity refers to statutory provisions

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Community Engagement & Public Participation

- May lead to:
  - More effective and equitable grantmaking
  - Improved trust in government and democratic accountability
- Meaningful incorporation of knowledge, needs, and lived experiences of affected individual and communities into program design, implementation, and evaluation

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Labor Standards

- Emphasizes the importance of:
  - Engaging organized labor
  - Using responsible contractors
- Outlines examples of permitted labor and employment practices

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Internal Controls

- Stresses the importance of internal controls and risk management practices
- Emphasizes data security and fraud prevention
- Encourages the use of electronic systems for managing grants and reporting

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Added "Documentation" Requirement

- 2 CFR 200.303(a) was revised to state that recipients and subrecipients should "Establish, **document**, and maintain effective internal control over Federal awards…"
  - Preamble states that not a change in policy
  - Some form of written documentation is already presumed to exist, as needed
  - No specific level of documentation is required

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Added "Cybersecurity" Requirement

- 2 CFR 200.303(a) was revised to state that a recipient of subrecipient take "reasonable cybersecurity and other measures to safeguard information including protected personally identifiable information and other types of information"
- No specific framework is required, while federal agencies may provide more specific guidance on the topic

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Whistleblowing Provisions

- An applicant, recipient, or subrecipient is now required to promptly disclose when it has "credible evidence" of violations of Federal criminal law involving fraud, conflict of interest, bribery, or gratuity violations
- Recipients and subrecipients must now inform employees in writing of whistleblower rights and protections

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Complying with Guidance in 2 CFR Section 200.203 Internal Controls

- Requirement is that the recipient must establish and maintain effective internal controls over Federal awards
  - Provide reasonable assurance that awards are being managed in compliance with Federal statutes, regulation, and the Federal award terms and conditions

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Internal Control Design Best Practices

- UG refers to the following documents as sources for best practices:
  - Standards for Internal Control in the Federal Government (Green Book)
  - Internal Control Framework issued by the Committee on Sponsoring Organizations (COSO)
- No expectation or requirement to document or evaluate prescriptively in accordance with these best practices
- Apply judgment in application to circumstances

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Audit and Monitoring Emphasized

- Highlights "evaluation" as an important priority to ensure intended goals are met
- Better ensuring subrecipients are properly managing and accounting for federal funds
- Risk-based audit approach will focus resources on higher-risk areas to better ensure that fraud and misuse of funds is better prevented or detected

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Reporting of Program Performance

- Eliminate reports not necessary for the effective monitoring of the grant
  - Only measure things that matter

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Procurement Standards

- Promotes transparency, competition, and accountability in the procurement process
- Ensure contracts are awarded in a manner that minimizes waste and inefficiency

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Purchasing Equipment Rules Changed

- Equipment and supply per unit value thresholds raised from $5,000 to $10,000 for what requires Federal agency or PTE approvals
  - Changes what items may be "retained, sold, or otherwise disposed of with no further responsibility to the federal agency"
  - Increases the total aggregate of "unused supplies" from $5,000 to $10,000 as to what is required to be sold at end of the grant period

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Discussion Question

If an entity has a $5,000 GAAP capitalization policy, given that the 2024 UG increased the “equipment” threshold to $10,0000, which threshold does the entity use?

- 2 CFR 200.1 states that the entity would use the “lesser” of the capitalization level established by the entity for F/S purposes or $10,000

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Discussion Question

If a PTE has a $5,000 GAAP capitalization policy, but a subrecipient has a $12,000 GAAP capitalization policy, which threshold should the subrecipient use under UG?

- The subrecipient would use the $10,000 amount, unless the subaward establishes a different requirement

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Removes Prior Written Approval For Certain Allowable Costs

1. Real property
2. Equipment
3. Direct costs
4. Entertainment
5. Memberships
6. Subscriptions
7. Professional activity costs
8. Participant support costs
9. Selling and marketing costs
10. Taxes

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Indirect Costs Rules Change

- De minimis indirect cost rate raised from 10% to 15%
  - Without requiring a negotiated rate
- Definition of "Modified Total Direct Costs" updated to exclude subawards > $50,000
  - Those < $50,000 can be applied to the indirect rate

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Uniform Guidance – Indirect De Minimis Rate

- Permits some to charge indirect costs at a rate of 15% of modified total direct costs
- Must not have a "current" negotiated indirect cost rate (NICRA)
- Rate must be used indefinitely
- Must be charged consistently for all awards
- Costs must be consistently charged as either direct and indirect, and not double-charged

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Discussion Question

Can an entity with a negotiated indirect cost rate agreement (NICRA) use the new de minimis rate going forward?

- Yes, once the NICRA expires

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Switching Indirect Cost Rate Strategies

- 200.414 (f) states that recipients and subrecipients that do not have a current Federal NICA (including provisional rate" may elect to charge the de minimis rate…
  - Including simply permitting one to expire
- The OMB Compliance Supplement suggested audit procedures should align with this new language going forward

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Discussion Question

What happens if an entity elects to use the de minimis rate at the beginning of an award, is it applicable to the award's entire period of performance?

- If a negotiated rate begins prior to the end of an award's period of performance, they are applied for costs moving forward

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PTE and Subrecipient – Use of De Minimis Rate

- If a PTE does not have a current negotiated actual indirect cost rate agreement with a subrecipient then either:
  - The subrecipient may use the 15% de minimis rate
  - Negotiate a rate with that subrecipient, which may be based on a prior negotiated agreement
- A Federal agency or PTE must recognize a federally-approved NICRA

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Other Key Points Related to Subrecipient Indirect Costs

- When a PTE uses Federal funds and its own funds to make a subaward, any NICRA must be applied consistently to both Federal and non-Federal funds for making the subaward
- There is no limit on the "layers" of subrecipients who may charge indirect costs under UG
  - The Federal award may specify a limit

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Discussion Question

If a PTE negotiates indirect costs with a subrecipient, are all PTEs obligated to also negotiate a rate with that subrecipient?

- No, each PTE determines an appropriate rate in collaboration with the subrecipient
- PTEs may not require a subrecipient without a negotiated rate to use less than the de minimis rate
  - Unless required by Federal statute or regulation

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Single Audit Applicability and Major Program Determination

1. Single audit threshold increased from $750,000 to $1 million
2. Type A threshold increased to $1 million
   - Amount expended for minimum was increased from $25 million to $34 million
3. Increases from $250,000 to $500,000 the amount of a fixed amount subaward that may be provided without prior written approval from the federal agency

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Effective Date of Single Audit Requirements

- Applicable to fiscal years beginning on or after October 1, 2024
  - September 30, 2025
  - December 31, 2025
  - March 31, 2026
  - June 30, 2026

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Questioned Costs Clarified

- Requires explanation for why questioned costs may be "undetermined" or "not reported"

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Questioned Costs Defined

- Amount, expended or received from a Federal award, that in the auditor's judgment:
  - Is noncompliant or suspected noncompliant with Federal statutes, regulations, or the terms and conditions of the Federal award, OR
  - At the time of the audit, lacked adequate documentation to support compliance, OR
  - Appeared unreasonable and did not reflect the actions a prudent person would take in the circumstances

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Questioned Cost Amount Defined

- The questioned cost amount is calculated as if the portion of a transaction that lacked adequate documentation were confirmed noncompliant
- There is no questioned cost SOLELY because of:
  - Deficiencies in internal control OR
  - Noncompliance with the reporting type of compliance requirement if it does not affect the amount expended or received from the award

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Types of Questioned Costs

- Known questions costs
  - Specifically identified by the auditor
- Likely questioned costs
  - Auditor's best estimate of total questioned costs, not just the known portion
  - E.g., projecting known questioned costs across the entire population is sampling

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Questioned Costs Clarification

- Both known and likely questioned costs are considered when opining on compliance
- Not considered improper until reviewed and confirmed to be so under A-123

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Assistance Listings

- Published www.sam.gov
  - Classifies federal financial assistance into program categories
- Great resource for determining what compliance requirements apply to a specific assistance listing

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Pulse Check

Do you learn something today?

A. Yes.

B. No.

C. Uncertain.

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Thank you!

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