

THE PPC ACCOUNTING AND AUDITING UPDATE

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Risk Assessment Impacts Peer Reviews



Risk assessment continues to garner much attention and focus in the audit community. In response to recent peer review deficiencies in this area, the AICPA Peer Review Board (PRB) has announced that risk assessment will be a prime area of focus in upcoming reviews. As a result, they are making a few significant changes to peer reviewers' audit engagement checklists.

Background

At the 2018 AICPA Peer Review Program Conference, risk assessment was the hot topic. Peer reviewers will be more carefully scrutinizing the way auditors apply risk assessment due to a relatively high volume of findings in this area. In the PRB's most recent review cycle, approximately 10% of firms were deemed to have nonconforming engagements due to noncompliance with the risk assessment requirements in AU-C 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, and

AU-C 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*.

Peer Review Checklist Changes

The peer review audit engagement checklist is being updated to reflect this emphasis on risk assessment. We expect these new changes to the audit engagement checklist to be effective for reviews as of May 1, 2019. The first general question on audit engagement risk assessment has been expanded to cover more specific risk assessment requirements, including documentation of the following:

- Obtaining an understanding of the entity and its environment.
- Obtaining an understanding of relevant internal controls, including the design and implementation of the controls.
- Identifying and assessing risk of material misstatement at the financial statement and relevant assertion levels.

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- Determining whether identified risks are significant risks and evaluating the design and implementation of relevant controls.
- Documenting linkage between the assessed risk of material misstatement and the audit response at the relevant assertion level.
- Identifying IT risks and linkage to related testing.

In addition, the checklists now ask for identification of the three areas with the highest assessed risk of material misstatement (it previously asked for “two to three”).

The Internal Control and Control Risks section has been retitled as Risk Assessment Procedures and Related Activities. Existing questions have been modified and new questions have been added regarding the following:

- Performing risk assessment procedures to provide a basis for identification and assessment of risk of material misstatement at the financial statement and relevant assertion levels.
- Documenting details of the auditor’s understanding of the entity and its environment.
- Obtaining an understanding of internal controls relevant to the audit.
- Identifying and assessing risk of material misstatement sufficient to provide a basis for designing and performing further audit procedures.
- Identifying fraud risks.
- Performing substantive procedures specifically responsive to the identified significant risks.
- Designing and performing further audit procedures based on, and responsive to, the assessed risks of material misstatement at the relevant assertion level.
- Updating the audit strategy and plan in response to risks identified over the course of the audit.

A question in the Inherent Risk section is modified to clarify whether the auditor’s rationale for the level of assessed risk is evident in the working papers. Other changes are made throughout the checklist to emphasize the need to assess the risk of material misstatement at the relevant assertion level. Reviewers are reminded when evaluating a “no” response to consider whether the error or omission is due to noncompliance with the risk assessment standards or improper testing procedures.

Practical Consideration:

For more details on risk assessment issues noted by peer reviewers, what to expect on your next peer review, and what you can do to prepare, see *The PPC Accounting and Auditing Update—Special Report*, published in September 2018 at thomsonreuterstaxsupport.secure.force.com/pkb/articles/News_Alerts/AAU-Special-Report-Risk-Assessment-Peer-Review-s-New-Hot-Topic/?q=The+PPC+Accounting+and+Auditing+Update%20%93Special+Report&t=News_Alerts__kav&fs=Search&pn=1.

AICPA Votes to Issue Omnibus SAS

The AICPA has voted to issue a final SAS, *Omnibus Statement on Auditing Standards—2019* (Omnibus SAS). The Omnibus SAS results from the evaluation of three auditing standards that have been issued by the Public Company Accounting Oversight Board (PCAOB) since the AICPA’s Auditing Standards Board (ASB) completed its auditing standards clarity project.

The ASB considered whether Auditing Standard (AS) 1301, *Communication With Audit Committees*; AS 2701, *Supplementary Information*; and AS 2410, *Related Parties*, included material that, if included in the requirements or application material of GAAS, would enhance audit quality for audits of financial statements of nonissuers in an effective and efficient manner. The ASB reviewed the three PCAOB auditing standards and, for each requirement in a PCAOB auditing standard that the ASB believed didn’t have an equivalent in GAAS, considered whether an amendment to GAAS was appropriate.

The Omnibus SAS will amend the following 13 sections of the Statements on Auditing Standards:

- AU-C 210, *Terms of Engagement*.
- AU-C 240, *Consideration of Fraud in a Financial Statement Audit*.

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The PPC Technology Update

by Roman H. Kepczyk, CPA.CITP, CGMA

Remote Work Changing Firm Technology

Auditors have long been the road warriors of the accounting profession, but, with the increase in mobile technologies and collaboration tools, we are seeing remote work being done by virtually every member of the firm, which is having an impact on the firm's overall technology strategy. To take advantage of the firmwide mobility trend, firm leadership needs to re-evaluate its long-standing positions on everything from IT infrastructure and equipment preferences to workflow and the respective policy changes. In this article we identify considerations to break the firm away from the status quo and take advantage of remote work capabilities that are providing leading firms a competitive advantage.

IT Infrastructure

The adoption of viable remote access technologies and the transition of more and more applications to cloud providers has allowed for all firm applications to be accessed remotely. This technological transition comes with the de facto benefit of allowing remote access not only for auditors, but for ALL firm members whose applications are now mobile-capable. There is a continuous trend of firms transitioning a significant portion (if not all) of the traditional internal network infrastructure to cloud-based accounting application providers, which in effect is reducing internal technical requirements for staffing, as well as network servers and storage. Firms still maintaining internal networks need to re-evaluate their IT strategy to identify the benefits of working virtually, and evaluate which technologies and vendors are the most viable, secure, and cost-effective, and the impact on IT staffing and capital expenditures. This trend is increasing the budget amounts for the application costs in the cloud while simultaneously reducing traditional IT capital budgets and staffing/training allocations, with many firms not taking into account the latter.



Equipment Decisions

Firms traditionally purchased laptops for auditors and desktops for tax, accounting, and administrative staff because of a historically significant difference in pricing and estimated life. Today, there is a trend toward firms purchasing laptops for more and more users not only for mobility, but for improved collaboration and as a hedge against environmental disasters. The transition to laptops and cloud/mobile applications has made the capital cost and expected equipment life differential inconsequential compared to the benefits of being able to work remotely.

The latest CPA Firm Management Association (CPAF-MA) technology survey found that the most common laptop formats (selected by 58% of firms) were those with 15.6" displays and a full 101 keyboard (including a 10-key number pad), followed by 23% selecting 17" models which also have the full keyboard. Firms still buying traditional 14" laptops should consider models with larger displays, as the size and weight of these units have come down significantly while providing the expanded screen real estate that tax and client services personnel need. While most auditors continue to utilize the 15.6" format, there is a growing trend toward senior management desiring even more mobility and transitioning to smaller formats such as Ultrabooks, Microsoft Surface computers, and 2-in-1 devices that have the functionality of both a laptop and a tablet (reducing the demand for iPads/tablets that many firms still purchase for senior management out of tradition).

Other traditional equipment decisions to be re-evaluated as firms expand their remote footprint are the integration of mobile monitors, Internet hot spots, and scanner/multi-function units. While most firms have recognized the benefits and standardized on multiple monitors within the office, they often overlook adding a secondary display for mobile users. 14" and 15" mobile displays from ASUS, HP, and Lenovo are under \$250 and allow remote users to work as effectively from a client office or home as in the firm's office. Remote Internet connectivity provided by clients is often the source of complaints among mobile staff, and using public WiFi (coffee shops, hotels, airports, etc.) comes with serious security concerns. The long-term solution that all firms should be re-evaluating is the use of mobile hotspots through employees' mobile phones or as stand-alone hot spot devices (MiFi) that connect through the 4G cellular system. Firms should re-evaluate their policies for digital cellular plan payment/stipends, as this will become the most manageable and secure Internet access method in the near term, particularly as the new 5G systems roll out across the country. The CPAFMA survey also found that more than half of firms were still carrying scanners/multi-function devices into the field; but, when auditors were asked how often they used them, the most common response was "seldom" and many never even took them out of their trunks. With more firms mandating the use of portals/secure email solutions and asking clients to provide digital files, firms should re-evaluate the need for carrying printers and scanners into the field and instead invest that portion of the equipment budget in educating clients on working digitally rather than on replacement scanners.

Collaborative Workflow

We have found that one of the hallmarks of efficient audit production is formalizing the process to receive all client source documents digitally before the start of the engagement. One of the most cited arguments against remote work is the inability to communicate directly with other team members who are not available when they are away from the office. Lack of direct access hinders workflow by making personnel wait until a necessary team member comes back into the office. Today's collaboration tools, such as Microsoft Teams, Skype, and Slack, provide remote personnel the ability to not only message, talk with, and see multiple firm personnel, but to share and edit documents simultaneously through the computer display. Firm leadership should be aware

of the benefits and time savings of being able to provide direction and assistance to firm personnel when it is needed and be educated on how remote collaboration tools make this possible. Traditional desktop computers did not come with video cameras and speakers attached, and while many firms added them for key users, they were seldom standardized within the entire firm, which significantly hindered adoption of collaborative tools. Firm owners need to realize that real-time collaboration is possible and that the benefits in managing firm workflow far outweigh the costs of implementing the hardware and educating users on working effectively with these tools.

Remote Policies

IT governance is often an overlooked component of a firm's technology strategy. While auditors have evolved with mobile technology adoption and set guidelines and policies as they worked remotely, other firm users are seldom aware of these policies and will need to be educated on them before they begin to work remotely. Firm owners will need to review their written policies from a larger, firmwide perspective and ensure that they include the different requirements for tax, client services, and administrative personnel. Considerations such as personal equipment usage, system maintenance, client confidentiality, communications, and availability will need to be addressed when updating policies.

Mobile/remote work capabilities provide firms with distinct competitive capabilities, but many firms have not taken the time to adjust their technology strategy to incorporate the changes required in their firms. Firm leadership should network with peers and attend upcoming industry conferences to identify the opportunities that remote workers provide and to understand the impact on their overall information technology strategy.

Roman H. Kepczyk is the Director of Firm Technology Strategy for Right Networks and consults exclusively with accounting firms throughout North America to implement today's digital best practices and technologies. In addition to being a CPA.CITP, he is a Lean Six Sigma Black Belt and incorporates Lean Six Sigma methodologies to help firm's optimize their production workflows. Roman is also an Advisory Board Member to the CPA Firm Management Association which has conducted the Digitally Driven and IT Benchmarks surveys biennially since 2003.



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- AU-C 260, *The Auditor's Communication With Those Charged With Governance*.
- AU-C 265, *Communicating Internal Control Deficiencies Identified in an Audit*.
- AU-C 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*.
- AU-C 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*.
- AU-C 510, *Opening Balances—Initial Audit Engagements, Including Reaudit Engagements*.
- AU-C 550, *Related Parties*.
- AU-C 560, *Subsequent Events and Subsequently Discovered Facts*.
- AU-C 580, *Written Representations*.
- AU-C 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*.
- AU-C 930, *Interim Financial Information*.
- AU-C 940, *An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Financial Statements*.

The most substantive amendments were to the following.

AU-C 260, The Auditor's Communication With Those Charged With Governance

The Omnibus SAS will adopt into AU-C 260 portions of PCAOB AS 1301, *Communications with Audit Committees*. It will require additional communications with those charged with governance and provide additional application guidance on documentation regarding the required communications.

AU-C 550, Related Parties

The Omnibus SAS will adopt into AU-C 550 portions of the PCAOB's AS 2410, *Related Parties*, and will sharpen the auditor's focus on related parties and on the entity's relationships and transactions with them. The SAS, among other amendments, will amend AU-C 550 to enhance inquiries of management, those charged with governance, and others within the entity regarding related parties and the nature of related-party transactions. The SAS enhances existing requirements to iden-

tify related parties or significant related-party transactions that were previously unidentified or undisclosed. Also, the auditor's response to the risks of material misstatement relating to related-party relationships and associated transactions is enhanced by including procedures for testing the completeness and accuracy of related-party relationships and transactions.

AU-C 240, Consideration of Fraud in a Financial Statement Audit.

The Omnibus SAS will also revise the definition of *significant unusual transactions* and the related auditing guidance, including the guidance in AU-C 240. It will define *significant unusual transactions* as "significant transactions that are outside the normal course of business for the entity or that are otherwise unusual due to their timing, size, or nature." The Omnibus SAS will also require auditors to inquire whether the entity has entered into any significant unusual transactions and, if so, the nature, terms, and business purpose of those transactions and whether those transactions were with related parties.

Other Amendments

In addition, the Omnibus SAS will amend AU-C 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)* to include, in the list of related parties prepared by group management and communicated to the component auditor, the nature of the entity's relationships and transactions with those related parties.

Certain amendments to AU-C 210, *Terms of Engagement*, will add to the possible inquiries of the predecessor auditor an inquiry about the predecessor auditor's understanding of the nature of the entity's relationships and transactions with related parties and significant unusual transactions.

Practical Consideration:

The final SAS is expected to be issued soon in connection with the proposed SAS on auditor reporting and is expected to be effective no earlier than for audits of financial statements for periods ending on or after December 15, 2020.



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PCAOB Staff Guidance Explains Expanded Audit Reporting Requirement

Public company auditors will soon be required to communicate CAMs in the auditor's report under the standard, AS 3101, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*. The Public Company Accounting Oversight Board (PCAOB) defines critical matters as issues that have been communicated to the audit committee, are related to accounts or disclosures that are material to the financial statements, and involve especially difficult judgment from the auditor. On March 18, 2019, the PCAOB published a set of three staff guidance documents developed to support implementation of the new critical audit matter (CAM) requirements.

Highlights of the Staff Guidance

The staff guidance consists of the following three documents:

- Implementation of Critical Audit Matters: The Basics.
- Implementation of Critical Audit Matters: Staff Observations from Review of Audit Methodologies.

- Implementation of Critical Audit Matters: A Deeper Dive on the Determination of CAMs.

While these documents primarily offer insights for auditors, the Implementation of Critical Audit Matters: The Basics provides a high-level overview and may also be of interest to preparers, audit committees, and investors.

The staff guidance was prepared based upon discussions with auditors regarding their experiences in doing "dry runs" or test runs of CAMs with their audit clients. The staff also reviewed the methodologies submitted by 10 U.S. audit firms, which collectively audit approximately 85 percent of large accelerated filers.

Effective Date

The standard is effective for audits of large accelerated filers for fiscal years ending on or after June 30, 2019. For smaller companies, AS 3101 is effective for fiscal years ending on or after December 15, 2020.

Practical Consideration:

The official release of the staff guidance is available at www.pcaobus.org and on Checkpoint at checkpoint.riag.com.

