

**Report on**  
  
**2016 Inspection of PMB Helin Donovan, LLP**  
**(Headquartered in Austin, Texas)**

**Issued by the**  
  
**Public Company Accounting Oversight Board**

**December 14, 2017**

**THIS IS A PUBLIC VERSION OF A PCAOB INSPECTION REPORT**

**PORTIONS OF THE COMPLETE REPORT ARE OMITTED  
FROM THIS DOCUMENT IN ORDER TO COMPLY WITH  
SECTIONS 104(g)(2) AND 105(b)(5)(A)  
OF THE SARBANES-OXLEY ACT OF 2002**

PCAOB RELEASE NO. 104-2018-047



## **2016 INSPECTION OF PMB HELIN DONOVAN, LLP**

### Preface

In 2016, the Public Company Accounting Oversight Board ("PCAOB" or "the Board") conducted an inspection of the registered public accounting firm PMB Helin Donovan, LLP ("the Firm") pursuant to the Sarbanes-Oxley Act of 2002 ("the Act").

Inspections are designed and performed to provide a basis for assessing the degree of compliance by a firm with applicable requirements related to auditing issuers. For a description of the procedures the Board's inspectors may perform to fulfill this responsibility, see Part I.C of this report (which also contains additional information concerning PCAOB inspections generally). The inspection included reviews of portions of selected issuer audits. These reviews were intended to identify whether deficiencies existed in the reviewed audit work, and whether such deficiencies indicated defects or potential defects in the Firm's system of quality control over audits. In addition, the inspection included a review of policies and procedures related to certain quality control processes of the Firm that could be expected to affect audit quality.

The Board is issuing this report in accordance with the requirements of the Act. The Board is releasing to the public Part I of the report and portions of Part IV of the report. Part IV of the report consists of the Firm's comments, if any, on a draft of the report. If the nonpublic portions of the report discuss criticisms of or potential defects in the firm's system of quality control, those discussions also could eventually be made public, but only to the extent the firm fails to address the criticisms to the Board's satisfaction within 12 months of the issuance of the report. Appendix A presents the text of the paragraphs of the auditing standards that are referenced in Part I.A. in relation to the description of auditing deficiencies there.

*Note on this report's citations to auditing standards:* On March 31, 2015, the PCAOB adopted a reorganization of its auditing standards using a topical structure and a single, integrated numbering system. See *Reorganization of PCAOB Auditing Standards and Related Amendments to PCAOB Standards and Rules*, PCAOB Release No. 2015-002 (Mar. 31, 2015). The reorganization became effective as of December 31, 2016. Citations in this report reference the reorganized PCAOB auditing standards.

**PROFILE OF THE FIRM<sup>1</sup>**

Offices	3 (Austin, Dallas, and Houston, Texas)
Ownership structure	Limited liability partnership
Partners / professional staff <sup>2</sup>	11 / 43
Issuer audit clients	18
Lead partners on issuer audit work <sup>3</sup>	4

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<sup>1</sup> The information presented here is as understood by the inspection team, generally as of the outset of the inspection, based on the Firm's self-reporting and the inspection team's review of certain information. Additional information, including additional detail on audit reports issued by the Firm, is available in the Firm's filings with the Board, available at [http://pcaobus.org/Registration/rasr/Pages/RASR\\_Search.aspx](http://pcaobus.org/Registration/rasr/Pages/RASR_Search.aspx).

<sup>2</sup> The number of partners and professional staff is provided here as an indication of the size of the Firm, and does not necessarily represent the number of the Firm's professionals who participate in audits of issuers. The number of partners cited above represents the number of individuals with an ownership interest in the Firm.

<sup>3</sup> The number of lead partners on issuer audit work represents the total number of Firm personnel (not necessarily limited to personnel with an ownership interest) who had primary responsibility for an issuer audit (as defined in AS 1201, *Supervision of the Audit Engagement*) during the twelve-month period preceding the outset of the inspection.

## **PART I**

### **INSPECTION PROCEDURES AND CERTAIN OBSERVATIONS**

Members of the Board's inspection staff ("the inspection team") conducted primary procedures for the inspection from September 12, 2016 to September 16, 2016.<sup>4</sup>

#### **A. Review of Audit Engagements**

The inspection procedures included review of portions of three issuer audits performed by the Firm. The inspection team identified matters that it considered to be deficiencies in the performance of the work it reviewed. One of the deficiencies relate to auditing aspects of an issuer's financial statements to which the issuer made adjustments after the primary inspection procedures.<sup>5</sup>

The descriptions of the deficiencies in Part I.A of this report include, at the end of the description of each deficiency, references to specific paragraphs of the auditing standards that relate to those deficiencies. The text of those paragraphs is set forth in Appendix A to this report. The references in this sub-Part include only standards that primarily relate to the deficiencies; they do not present a comprehensive list of every auditing standard that applies to the deficiencies. Further, certain broadly applicable aspects of the auditing standards that may be relevant to a deficiency, such as provisions requiring due professional care, including the exercise of professional skepticism; the accumulation of sufficient appropriate audit evidence; and the performance of procedures that address risks, are not included in any references to the auditing standards in this sub-Part, unless the lack of compliance with these standards is the primary reason for the deficiency. These broadly applicable provisions are described in Part I.B of this report.

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<sup>4</sup> For this purpose, "primary procedures" include field work, other review of audit work papers, and the evaluation of the Firm's quality control policies and procedures through review of documentation and interviews of Firm personnel. Primary procedures do not include (1) inspection planning, which is performed prior to primary procedures, and (2) inspection follow-up procedures, wrap-up, analysis of results, and the preparation of the inspection report, which extend beyond the primary procedures.

<sup>5</sup> The 2016 inspection did not include review of any additional audit work related to the adjustments.

Certain deficiencies identified were of such significance that it appeared to the inspection team that the Firm, at the time it issued its audit report, had not obtained sufficient appropriate audit evidence to support its opinion that the financial statements were presented fairly, in all material respects, in accordance with the applicable financial reporting framework. In other words, in these audits, the auditor issued an opinion without satisfying its fundamental obligation to obtain reasonable assurance about whether the financial statements were free of material misstatement.

The fact that one or more deficiencies in an audit reach this level of significance does not necessarily indicate that the financial statements are materially misstated. It is often not possible for the inspection team, based only on the information available from the auditor, to reach a conclusion on those points. As indicated below, however, in two instances, the inspection team identified failures by the Firm to identify and address appropriately departures from Generally Accepted Accounting Principles ("GAAP") that appeared to the inspection team to be material.

Whether or not associated with a disclosed financial reporting misstatement, an auditor's failure to obtain the reasonable assurance that the auditor is required to obtain is a serious matter. It is a failure to accomplish the essential purpose of the audit, and it means that, based on the audit work performed, the audit opinion should not have been issued.<sup>6</sup>

The audit deficiencies that reached this level of significance are described below—

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<sup>6</sup> Inclusion in an inspection report does not mean that the deficiency remained unaddressed after the inspection team brought it to the Firm's attention. Depending upon the circumstances, compliance with PCAOB standards may require the Firm to perform additional audit procedures, or to inform a client of the need for changes to its financial statements or reporting on internal control, or to take steps to prevent reliance on its previously expressed audit opinions. The Board expects that firms will comply with these standards, and an inspection may include a review of the adequacy of a firm's compliance with these requirements, either with respect to previously identified deficiencies or deficiencies identified during that inspection. Failure by a firm to take appropriate actions, or a firm's misrepresentations in responding to an inspection report, about whether it has taken such actions, could be a basis for Board disciplinary sanctions.

A.1. Issuer A

- (1) the Firm's failure to identify, or to address appropriately, departures from GAAP that appeared to the inspection team to be material, which related to the omission from the financial statements of disclosures related to revenue, accounts receivable, and related party transactions (AS 2810.30 and .31);
- (2) the failure to perform sufficient procedures to test revenue, including the inadequate performance of substantive analytical procedures (AS 1105.10; AS 2301.13; AS 2305.05, .13, .14, and .21; AS 2810.30); and
- (3) the failure to perform sufficient procedures to evaluate an intangible asset for impairment (AS 2502.26 and .28).

A.2. Issuer B

- (1) the Firm's failure to identify, or to address appropriately, departures from GAAP that appeared to the inspection team to be material, which related to the omission from the financial statements of disclosures related to a business combination and intangible assets (AS 2810.30 and .31);
- (2) the failure to perform sufficient procedures to test the valuation of assets acquired (AS 2502.03 and .15); and
- (3) the failure to perform sufficient procedures to evaluate the useful lives and method of amortization of assets acquired (AS 2501.04).

A.3. Issuer C

- (1) the failure to perform sufficient procedures to test the occurrence and allocation of revenue, including the use of sampling with a sample size that was too small due to an unsupported level of reliance on controls, and the failure to evaluate exceptions identified in the sample items selected for testing (AS 2301.16, .18, and .37; AS 2315.19, .23, .23A, and .25);

(2) the failure to perform sufficient procedures to test the existence of accounts receivable (AS 2310.33); and

(3) the failure, in testing the valuation of a liability, to perform procedures to test the accuracy and completeness of data provided by the issuer to a specialist whose work the Firm used (AS 1210.12).

## **B. Auditing Standards**

Each deficiency described above could relate to several applicable provisions of the standards that govern the conduct of audits. The paragraphs of the standards that are cited for each deficiency are those that most directly relate to the deficiency. The deficiencies also relate, however, to other paragraphs of those standards and to other auditing standards, including those concerning due professional care, responses to risk assessments, and audit evidence.

Many audit deficiencies involve a lack of due professional care. Paragraphs .02, .05, and .06 of AS 1015, *Due Professional Care in the Performance of Work*, require the independent auditor to plan and perform his or her work with due professional care and sets forth aspects of that requirement. AS 1015.07-.09, and paragraph .07 of AS 2301, *The Auditor's Responses to the Risks of Material Misstatement*, specify that due professional care requires the exercise of professional skepticism. These standards state that professional skepticism is an attitude that includes a questioning mind and a critical assessment of the appropriateness and sufficiency of audit evidence.

AS 2301.03, .05, and .08, require the auditor to design and implement audit responses that address the risks of material misstatement, and paragraph .04 of AS 1105, *Audit Evidence*, requires the auditor to plan and perform audit procedures to obtain sufficient appropriate audit evidence to provide a reasonable basis for the audit opinion. Sufficiency is the measure of the quantity of audit evidence, and the quantity needed is affected by the risk of material misstatement (in the audit of financial statements) and the quality of the audit evidence obtained. The appropriateness of evidence is measured by its quality; to be appropriate, evidence must be both relevant and reliable in providing support for the related conclusions.

The paragraphs of the standards that are described immediately above are not cited in Part I.A, unless those paragraphs are the most directly related to the relevant deficiency.



**B.1. List of Specific Auditing Standards Referenced in Part I.A.**

The table below lists the specific auditing standards that are referenced in Part I.A of this report, cross-referenced to the issuer audits for which each standard is cited.

PCAOB Auditing Standards	Issuers
AS 1105, <i>Audit Evidence</i>	A
AS 1210, <i>Using the Work of a Specialist</i>	C
AS 2301, <i>The Auditor's Responses to the Risks of Material Misstatement</i>	A and C
AS 2305, <i>Substantive Analytical Procedures</i>	A
AS 2310, <i>The Confirmation Process</i>	C
AS 2315, <i>Audit Sampling</i>	C
AS 2501, <i>Auditing Accounting Estimates</i>	B
AS 2502, <i>Auditing Fair Value Measurements and Disclosures</i>	A and B
AS 2810, <i>Evaluating Audit Results</i>	A and B

**C. Information Concerning PCAOB Inspections that is Generally Applicable to Triennially Inspected Firms**

A Board inspection includes a review of certain portions of selected audit work performed by the inspected firm and a review of certain aspects of the firm's quality control system. The inspections are designed to identify deficiencies in audit work and defects or potential defects in the firm's system of quality control related to the firm's audits. The focus on deficiencies, defects, and potential defects necessarily carries through to reports on inspections and, accordingly, Board inspection reports are not intended to serve as balanced report cards or overall rating tools. Further, the inclusion



in an inspection report of certain deficiencies, defects, and potential defects should not be construed as an indication that the Board has made any determination about other aspects of the inspected firm's systems, policies, procedures, practices, or conduct not included within the report.

### C.1. Reviews of Audit Work

Inspections include reviews of portions of selected audits of financial statements and, where applicable, audits of internal control over financial reporting ("ICFR"). For these audits, the inspection team selects certain portions of the audits for inspection, and it reviews the engagement team's work papers and interviews engagement personnel regarding those portions. If the inspection team identifies a potential issue that it is unable to resolve through discussion with the firm and any review of additional work papers or other documentation, the inspection team ordinarily provides the firm with a written comment form on the matter and the firm is allowed the opportunity to provide a written response to the comment form. If the response does not resolve the inspection team's concerns, the matter is considered a deficiency and is evaluated for inclusion in the inspection report.

The inspection team selects the audits, and the specific portions of those audits, that it will review, and the inspected firm is not allowed an opportunity to limit or influence the selections. Audit deficiencies that the inspection team may identify include a firm's failure to identify, or to address appropriately, financial statement misstatements, including failures to comply with disclosure requirements,<sup>7</sup> as well as a firm's failure to perform, or to perform sufficiently, certain necessary audit procedures. An inspection may not involve the review of all of the firm's audits, nor is it designed to identify every deficiency in the reviewed audits. Accordingly, a Board inspection report should not be understood to provide any assurance that a firm's audit work, or the

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<sup>7</sup> When it comes to the Board's attention that an issuer's financial statements appear not to present fairly, in a material respect, the financial position, results of operations, or cash flows of the issuer in conformity with the applicable financial reporting framework, the Board's practice is to report that information to the Securities and Exchange Commission ("SEC" or "the Commission"), which has jurisdiction to determine proper accounting in issuers' financial statements. Any description in this report of financial statement misstatements or failures to comply with SEC disclosure requirements should not be understood as an indication that the SEC has considered or made any determination regarding these issues unless otherwise expressly stated.

relevant issuers' financial statements or reporting on ICFR, are free of any deficiencies not specifically described in an inspection report.

In some cases, the conclusion that a firm did not perform a procedure may be based on the absence of documentation and the absence of persuasive other evidence, even if the firm claimed to have performed the procedure. AS 1215, *Audit Documentation*, provides that, in various circumstances including PCAOB inspections, a firm that has not adequately documented that it performed a procedure, obtained evidence, or reached an appropriate conclusion must demonstrate with persuasive other evidence that it did so, and that oral assertions and explanations alone do not constitute persuasive other evidence. In reaching its conclusions, an inspection team considers whether audit documentation or other evidence that a firm might provide to the inspection team supports the firm's contention that it performed a procedure, obtained evidence, or reached an appropriate conclusion. In the case of every matter cited in the public portion of a final inspection report, the inspection team has carefully considered any contention by the firm that it did so but just did not document its work, and the inspection team has concluded that the available evidence does not support the contention that the firm sufficiently performed the necessary work.

Identified deficiencies in the audit work that exceed a significance threshold (which is described in Part I.A of the inspection report) are summarized in the public portion of the inspection report.<sup>8</sup>

The Board cautions against extrapolating from the results presented in the public portion of a report to broader conclusions about the frequency of deficiencies throughout the firm's practice. Individual audits and areas of inspection focus are most often selected on a risk-weighted basis and not randomly. Areas of focus vary among selected audits, but often involve audit work on the most difficult or inherently uncertain areas of financial statements. Thus, the audit work is generally selected for inspection based on factors that, in the inspection team's view, heighten the possibility that auditing

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<sup>8</sup> The discussion in this report of any deficiency observed in a particular audit reflects information reported to the Board by the inspection team and does not reflect any determination by the Board as to whether the Firm has engaged in any conduct for which it could be sanctioned through the Board's disciplinary process. In addition, any references in this report to violations or potential violations of law, rules, or professional standards are not a result of an adversarial adjudicative process and do not constitute conclusive findings for purposes of imposing legal liability.

deficiencies are present, rather than through a process intended to identify a representative sample.

## C.2. Review of a Firm's Quality Control System

QC 20, *System of Quality Control for a CPA Firm's Accounting and Auditing Practice*, provides that an auditing firm has a responsibility to ensure that its personnel comply with the applicable professional standards. This standard specifies that a firm's system of quality control should encompass the following elements: (1) independence, integrity, and objectivity; (2) personnel management; (3) acceptance and continuance of issuer audit engagements; (4) engagement performance; and (5) monitoring.

The inspection team's assessment of a firm's quality control system is derived both from the results of its procedures specifically focused on the firm's quality control policies and procedures, and also from inferences that can be drawn from deficiencies in the performance of individual audits. Audit deficiencies, whether alone or when aggregated, may indicate areas where a firm's system has failed to provide reasonable assurance of quality in the performance of audits. Even deficiencies that do not result in an insufficiently supported audit opinion may indicate a defect or potential defect in a firm's quality control system.<sup>9</sup> If identified deficiencies, when accumulated and evaluated, indicate defects or potential defects in the firm's system of quality control, the nonpublic portion of this report would include a discussion of those issues. When evaluating whether identified deficiencies in individual audits indicate a defect or potential defect in a firm's system of quality control, the inspection team considers the nature, significance, and frequency of deficiencies;<sup>10</sup> related firm methodology, guidance, and practices; and possible root causes.

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<sup>9</sup> Not every audit deficiency suggests a defect or potential defect in a firm's quality control system, and this report may not discuss every audit deficiency the inspection team identified.

<sup>10</sup> An evaluation of the frequency of a type of deficiency may include consideration of how often the inspection team reviewed audit work that presented the opportunity for similar deficiencies to occur. In some cases, even a type of deficiency that is observed infrequently in a particular inspection may, because of some combination of its nature, its significance, and the frequency with which it has been observed in previous inspections of the firm, be cause for concern about a quality control defect or potential defect.

Inspections also include a review of certain of the firm's practices, policies, and processes related to audit quality, which constitute a part of the firm's quality control system. This review addresses practices, policies, and procedures concerning audit performance, training, compliance with independence standards, client acceptance and retention, and the establishment of policies and procedures.

END OF PART I

PARTS II AND III OF THIS REPORT ARE NONPUBLIC  
AND ARE OMITTED FROM THIS PUBLIC DOCUMENT

## **PART IV**

### **RESPONSE OF THE FIRM TO DRAFT INSPECTION REPORT**

Pursuant to section 104(f) of the Act, 15 U.S.C. § 7214(f), and PCAOB Rule 4007(a), the Firm provided a written response to a draft of this report. Pursuant to section 104(f) of the Act and PCAOB Rule 4007(b), the Firm's response, minus any portion granted confidential treatment, is attached hereto and made part of this final inspection report.<sup>11</sup>

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<sup>11</sup> The Board does not make public any of a firm's comments that address a nonpublic portion of the report unless a firm specifically requests otherwise. In some cases, the result may be that none of a firm's response is made publicly available. In addition, pursuant to section 104(f) of the Act, 15 U.S.C. § 7214(f), and PCAOB Rule 4007(b), if a firm requests, and the Board grants, confidential treatment for any of the firm's comments on a draft report, the Board does not include those comments in the final report at all. The Board routinely grants confidential treatment, if requested, for any portion of a firm's response that addresses any point in the draft that the Board omits from, or any inaccurate statement in the draft that the Board corrects in, the final report.

# PMB Helin Donovan

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November 3, 2017

Helen Munter, Director  
Division of Registration and Inspections  
Public Company Accounting Oversight Board  
1666 K Street, N.W.  
Washington, D.C. 20006

RE: October 3, 2017 Draft Report on 2016 Inspection of PMB Helin Donovan, LLP

Dear Ms. Munter:

We are pleased to provide our response to the Public Company Accounting Oversight Board's ("PCAOB") draft report on the 2016 inspection of PMB Helin Donovan, LLP ("PMBHD" or the "Firm"). PMBHD is committed to improving the performance and quality of our audits.

There were 3 Issuer Audits addressed in the Draft Inspection Report:

1. Issuer A-There were 3 findings. The primary comments are related to revenue recognition, accounts receivable, and accounting for intangible assets.
2. Issuer B-There were 4 findings. They were primarily related to the disclosures for a business combination.
3. Issuer C-There were 3 findings. These were related to sample size in revenue testing, existence of accounts receivable, and testing of an actuary report.

We considered Rule 4007- Firm Responses to Draft Inspection Report in preparing this letter.

The inspection matters noted in Part I - Inspection Procedures and Certain Observations have been evaluated and appropriate action has been taken in accordance with PMBHD's policies and PCAOB standards.

We intend to enhance our Firm's training programs and policies and practice aids to address the PCAOB's findings.

PMBHD is committed to improving the performance and quality of our audits, and as such, supports the PCAOB inspection as a means to evaluate and improve the performance and quality of our audit engagements.

We look forward to continuing to work with the PCAOB to improve the quality of our audit engagements and quality controls.

Austin • Dallas • Houston





## PMB Helin Donovan

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REDACTED. Comments on Non-public Aspects of Report

## **PMB Helin Donovan**

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Helen Munter, Director  
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Please contact me at (512) 583-2908 or via e-mail at [tdonovan@pmbhd.com](mailto:tdonovan@pmbhd.com) with any questions regarding this letter.

**PMB Helin Donovan, LLP**

A handwritten signature in black ink that reads "Thomas P. Donovan". The signature is written in a cursive, flowing style.

Thomas P. Donovan, CPA  
Partner

## APPENDIX A

### AUDITING STANDARDS REFERENCED IN PART I.A

This appendix provides the text of the auditing standard paragraphs that are referenced in Part I.A of this report. Footnotes that are included in this appendix, and any other Notes, are from the original auditing standards that are referenced. While this appendix contains the specific portions of the relevant standards cited with respect to the deficiencies in Part I.A of this report, other portions of the standards (including those described in Part I.B of this report) may provide additional context, descriptions, related requirements, or explanations; the complete standards are available on the PCAOB's website at <http://pcaobus.org/STANDARDS/Pages/default.aspx>.

<b>AS 1105, <i>Audit Evidence</i></b>		
<b>SUFFICIENT APPROPRIATE AUDIT EVIDENCE</b>		
<b>Using Information Produced by the Company</b>		
AS 1105.10	<p>When using information produced by the company as audit evidence, the auditor should evaluate whether the information is sufficient and appropriate for purposes of the audit by performing procedures to:<sup>3</sup></p> <ul style="list-style-type: none"> <li>• Test the accuracy and completeness of the information, or test the controls over the accuracy and completeness of that information; and</li> <li>• Evaluate whether the information is sufficiently precise and detailed for purposes of the audit.</li> </ul>	Issuer A
<p><u>Footnote to AS 1105.10</u></p> <p><sup>3</sup> When using the work of a specialist engaged or employed by management, <u>see</u> AS 1210, <i>Using the Work of a Specialist</i>. When using information produced by a service organization or a service auditor's report as audit evidence, <u>see</u> AS 2601, <i>Consideration of an Entity's Use of a Service Organization</i>, and for integrated audits, <u>see</u> AS 2201, <i>An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements</i>.</p>		

<b>AS 1210, <i>Using the Work of a Specialist</i></b>		
<b>USING THE FINDINGS OF THE SPECIALIST</b>		
AS 1210.12	The appropriateness and reasonableness of methods and assumptions used and their application are the responsibility of the specialist. The auditor should (a) obtain an understanding of the methods and assumptions used by the specialist, (b) make appropriate tests of data provided to the specialist, taking into account the auditor's assessment of control risk, and (c) evaluate whether the specialist's findings support the related assertions in the financial statements. Ordinarily, the auditor would use the work of the specialist unless the auditor's procedures lead him or her to believe the findings are unreasonable in the circumstances. If the auditor believes the findings are unreasonable, he or she should apply additional procedures, which may include obtaining the opinion of another specialist.	Issuer C

<b>AS 2301, <i>The Auditor's Responses to the Risks of Material Misstatement</i></b>		
<b>RESPONSES INVOLVING THE NATURE, TIMING, AND EXTENT OF AUDIT PROCEDURES</b>		
<b>Responses to Fraud Risks</b>		
AS 2301.13	<i>Addressing Fraud Risks in the Audit of Financial Statements.</i> In the audit of financial statements, the auditor should perform substantive procedures, including tests of details, that are specifically responsive to the assessed fraud risks. If the auditor selects certain controls intended to address the assessed fraud risks for testing in accordance with paragraphs .16-.17 of this standard, the auditor should perform tests of those controls.	Issuer A
<b>TESTING CONTROLS</b>		
<b>Testing Controls in an Audit of Financial Statements</b>		
AS 2301.16	<i>Controls to be Tested.</i> If the auditor plans to assess control risk at less than the maximum by relying on controls, <sup>12</sup> and the nature, timing, and extent of planned substantive procedures are based on that lower assessment, the auditor must obtain evidence that the controls selected for testing are	Issuer C

<b>AS 2301, The Auditor's Responses to the Risks of Material Misstatement</b>		
	designed effectively and operated effectively during the entire <b>period of reliance</b> . <sup>13</sup> However, the auditor is not required to assess control risk at less than the maximum for <i>all</i> relevant assertions and, for a variety of reasons, the auditor may choose not to do so.	
<p><u>Footnotes to AS 2301.16</u></p> <p><sup>12</sup> Reliance on controls that is supported by sufficient and appropriate audit evidence allows the auditor to assess control risk at less than the maximum, which results in a lower assessed risk of material misstatement. In turn, this allows the auditor to modify the nature, timing, and extent of planned substantive procedures.</p> <p><sup>13</sup> Terms defined in Appendix A, <i>Definitions</i>, are set in <b>boldface type</b> the first time they appear.</p>		
AS 2301.18	<i>Evidence about the Effectiveness of Controls in the Audit of Financial Statements.</i> In designing and performing tests of controls for the audit of financial statements, the evidence necessary to support the auditor's control risk assessment depends on the degree of reliance the auditor plans to place on the effectiveness of a control. The auditor should obtain more persuasive audit evidence from tests of controls the greater the reliance the auditor places on the effectiveness of a control. The auditor also should obtain more persuasive evidence about the effectiveness of controls for each relevant assertion for which the audit approach consists primarily of tests of controls, including situations in which substantive procedures alone cannot provide sufficient appropriate audit evidence.	Issuer C
<b>SUBSTANTIVE PROCEDURES</b>		
AS 2301.37	As the assessed risk of material misstatement increases, the evidence from substantive procedures that the auditor should obtain also increases. The evidence provided by the auditor's substantive procedures depends upon the mix of the nature, timing, and extent of those procedures. Further, for an individual assertion, different combinations of the nature, timing, and extent of testing might provide sufficient appropriate evidence to respond to the assessed risk of material misstatement.	Issuer C

<b>AS 2305, Substantive Analytical Procedures</b>		
AS 2305.05	<p>Analytical procedures involve comparisons of recorded amounts, or ratios developed from recorded amounts, to expectations developed by the auditor. The auditor develops such expectations by identifying and using plausible relationships that are reasonably expected to exist based on the auditor's understanding of the client and of the industry in which the client operates. Following are examples of sources of information for developing expectations:</p> <ul style="list-style-type: none"> <li>a. Financial information for comparable prior period(s) giving consideration to known changes</li> <li>b. Anticipated results—for example, budgets, or forecasts including extrapolations from interim or annual data</li> <li>c. Relationships among elements of financial information within the period</li> <li>d. Information regarding the industry in which the client operates—for example, gross margin information</li> <li>e. Relationships of financial information with relevant nonfinancial information</li> </ul>	Issuer A
<b>ANALYTICAL PROCEDURES USED AS SUBSTANTIVE TESTS</b>		
<b>Plausibility and Predictability of the Relationship</b>		
AS 2305.13	<p>It is important for the auditor to understand the reasons that make relationships plausible because data sometimes appear to be related when they are not, which could lead the auditor to erroneous conclusions. In addition, the presence of an unexpected relationship can provide important evidence when appropriately scrutinized.</p>	Issuer A
AS 2305.14	<p>As higher levels of assurance are desired from analytical procedures, more predictable relationships are required to develop the expectation. Relationships in a stable environment are usually more predictable than relationships</p>	Issuer A

<b>AS 2305, Substantive Analytical Procedures</b>		
	in a dynamic or unstable environment. Relationships involving income statement accounts tend to be more predictable than relationships involving only balance sheet accounts since income statement accounts represent transactions over a period of time, whereas balance sheet accounts represent amounts as of a point in time. Relationships involving transactions subject to management discretion are sometimes less predictable. For example, management may elect to incur maintenance expense rather than replace plant and equipment, or they may delay advertising expenditures.	
<b>Investigation and Evaluation of Significant Differences</b>		
AS 2305.21	The auditor should evaluate significant unexpected differences. Reconsidering the methods and factors used in developing the expectation and inquiry of management may assist the auditor in this regard. Management responses, however, should ordinarily be corroborated with other evidential matter. In those cases when an explanation for the difference cannot be obtained, the auditor should obtain sufficient evidence about the assertion by performing other audit procedures to satisfy himself as to whether the difference is a misstatement. In designing such other procedures, the auditor should consider that unexplained differences may indicate an increased risk of material misstatement. ( <u>See</u> AS 2810.)	Issuer A

<b>AS 2310, The Confirmation Process</b>		
<b>EVALUATING THE RESULTS OF CONFIRMATION PROCEDURES</b>		
AS 2310.33	After performing any alternative procedures, the auditor should evaluate the combined evidence provided by the confirmations and the alternative procedures to determine whether sufficient evidence has been obtained about all the applicable financial statement assertions. In performing that evaluation, the auditor should consider (a) the reliability of the confirmations and alternative procedures; (b) the nature of any exceptions, including the implications, both quantitative and qualitative, of those exceptions; (c) the evidence	Issuer C



<b>AS 2310, The Confirmation Process</b>		
	provided by other procedures; and (d) whether additional evidence is needed. If the combined evidence provided by the confirmations, alternative procedures, and other procedures is not sufficient, the auditor should request additional confirmations or extend other tests, such as tests of details or analytical procedures.	

<b>AS 2315, Audit Sampling</b>		
<b>SAMPLING IN SUBSTANTIVE TESTS OF DETAILS</b>		
<b>Planning Samples</b>		
AS 2315.19	After assessing and considering the levels of inherent and control risks, the auditor performs substantive tests to restrict detection risk to an acceptable level. As the assessed levels of inherent risk, control risk, and detection risk for other substantive procedures directed toward the same specific audit objective decreases, the auditor's allowable risk of incorrect acceptance for the substantive tests of details increases and, thus, the smaller the required sample size for the substantive tests of details. For example, if inherent and control risks are assessed at the maximum, and no other substantive tests directed toward the same specific audit objectives are performed, the auditor should allow for a low risk of incorrect acceptance for the substantive tests of details. <sup>3</sup> Thus, the auditor would select a larger sample size for the tests of details than if he allowed a higher risk of incorrect acceptance.	Issuer C
<b>Footnote to AS 2315.19</b>  <sup>3</sup> Some auditors prefer to think of risk levels in quantitative terms. For example, in the circumstances described, an auditor might think in terms of a 5 percent risk of incorrect acceptance for the substantive test of details. Risk levels used in sampling applications in other fields are not necessarily relevant in determining appropriate levels for applications in auditing because an audit includes many interrelated tests and sources of evidence.		
AS 2315.23	To determine the number of items to be selected in a sample for a particular substantive test of details, the auditor should take into account tolerable misstatement for the population; the allowable risk of incorrect acceptance (based	Issuer C

<b>AS 2315, Audit Sampling</b>		
	on the assessments of inherent risk, control risk, and the detection risk related to the substantive analytical procedures or other relevant substantive tests); and the characteristics of the population, including the expected size and frequency of misstatements.	
AS 2315.23A	Table 1 of the Appendix describes the effects of the factors discussed in the preceding paragraph on sample sizes in a statistical or nonstatistical sampling approach. When circumstances are similar, the effect on sample size of those factors should be similar regardless of whether a statistical or nonstatistical approach is used. Thus, when a nonstatistical sampling approach is applied properly, the resulting sample size ordinarily will be comparable to, or larger than, the sample size resulting from an efficient and effectively designed statistical sample.	Issuer C
<b>Performance and Evaluation</b>		
AS 2315.25	Auditing procedures that are appropriate to the particular audit objective should be applied to each sample item. In some circumstances the auditor may not be able to apply the planned audit procedures to selected sample items because, for example, supporting documentation may be missing. The auditor's treatment of unexamined items will depend on their effect on his evaluation of the sample. If the auditor's evaluation of the sample results would not be altered by considering those unexamined items to be misstated, it is not necessary to examine the items. However, if considering those unexamined items to be misstated would lead to a conclusion that the balance or class contains material misstatement, the auditor should consider alternative procedures that would provide him with sufficient evidence to form a conclusion. The auditor also should evaluate whether the reasons for his or her inability to examine the items have (a) implications in relation to his or her risk assessments (including the assessment of fraud risk), (b) implications regarding the integrity of management or employees, and (c) possible effects on other aspects of the audit.	Issuer C

**AS 2501, Auditing Accounting Estimates**

AS 2501.04	The auditor is responsible for evaluating the reasonableness of accounting estimates made by management in the context of the financial statements taken as a whole. As estimates are based on subjective as well as objective factors, it may be difficult for management to establish controls over them. Even when management's estimation process involves competent personnel using relevant and reliable data, there is potential for bias in the subjective factors. Accordingly, when planning and performing procedures to evaluate accounting estimates, the auditor should consider, with an attitude of professional skepticism, both the subjective and objective factors.	Issuer B
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**AS 2502, Auditing Fair Value Measurements and Disclosures**

<b>INTRODUCTION</b>		
AS 2502.03	The auditor should obtain sufficient appropriate audit evidence to provide reasonable assurance that fair value measurements and disclosures are in conformity with GAAP. GAAP requires that certain items be measured at fair value. Financial Accounting Standards Board (FASB) Statement of Financial Accounting Concepts No. 7, <i>Using Cash Flow Information and Present Value in Accounting Measurements</i> , defines the fair value of an asset (liability) as "the amount at which that asset (or liability) could be bought (or incurred) or sold (or settled) in a current transaction between willing parties, that is, other than in a forced or liquidation sale." <sup>1</sup> Although GAAP may not prescribe the method for measuring the fair value of an item, it expresses a preference for the use of observable market prices to make that determination. In the absence of observable market prices, GAAP requires fair value to be based on the best information available in the circumstances.	Issuer B

Footnote to AS 2502.03

<sup>1</sup> Generally accepted accounting principles (GAAP) contain various definitions of fair value. However, all of the definitions reflect the concepts in the definition that appears in Financial Accounting Standards Board (FASB) Statement of Financial Accounting Concepts No. 7, *Using Cash Flow Information and Present Value in Accounting Measurements*. For example, Governmental Accounting Standards Board Statement of Governmental Accounting Standards No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*, defines fair value as "the amount at which an investment could

<b>AS 2502, Auditing Fair Value Measurements and Disclosures</b>		
be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale."		
<b>EVALUATING CONFORMITY OF FAIR VALUE MEASUREMENTS AND DISCLOSURES WITH GAAP</b>		
AS 2502.15	The auditor should evaluate whether the fair value measurements and disclosures in the financial statements are in conformity with GAAP. The auditor's understanding of the requirements of GAAP and knowledge of the business and industry, together with the results of other audit procedures, are used to evaluate the accounting for assets or liabilities requiring fair value measurements, and the disclosures about the basis for the fair value measurements and significant uncertainties related thereto.	Issuer B
<b>TESTING THE ENTITY'S FAIR VALUE MEASUREMENTS AND DISCLOSURES</b>		
<b>Testing Management's Significant Assumptions, the Valuation Model, and the Underlying Data</b>		
AS 2502.26	<p>The auditor's understanding of the reliability of the process used by management to determine fair value is an important element in support of the resulting amounts and therefore affects the nature, timing, and extent of audit procedures. When testing the entity's fair value measurements and disclosures, the auditor evaluates whether:</p> <ul style="list-style-type: none"> <li>a. Management's assumptions are reasonable and reflect, or are not inconsistent with, market information (<u>see</u> paragraph .06).</li> <li>b. The fair value measurement was determined using an appropriate model, if applicable.</li> <li>c. Management used relevant information that was reasonably available at the time.</li> </ul>	Issuer A
AS 2502.28	Where applicable, the auditor should evaluate	Issuer A

**AS 2502, Auditing Fair Value Measurements and Disclosures**

	whether the significant assumptions used by management in measuring fair value, taken individually and as a whole, provide a reasonable basis for the fair value measurements and disclosures in the entity's financial statements.	
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**AS 2810, Evaluating Audit Results**

<b>EVALUATING THE RESULTS OF THE AUDIT OF FINANCIAL STATEMENTS</b>		
<b>Evaluating the Presentation of the Financial Statements, Including the Disclosures</b>		
AS 2810.30	<p>The auditor must evaluate whether the financial statements are presented fairly, in all material respects, in conformity with the applicable financial reporting framework.</p> <p>Note: AS 2815, <i>The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles</i>, establishes requirements for evaluating the presentation of the financial statements. AS 2820, <i>Evaluating Consistency of Financial Statements</i>, establishes requirements regarding evaluating the consistency of the accounting principles used in financial statements.</p> <p>Note: The auditor should look to the requirements of the Securities and Exchange Commission for the company under audit with respect to the accounting principles applicable to that company.</p>	Issuers A and B
AS 2810.31	<p>As part of the evaluation of the presentation of the financial statements, the auditor should evaluate whether the financial statements contain the information essential for a fair presentation of the financial statements in conformity with the applicable financial reporting framework. Evaluation of the information disclosed in the financial statements includes consideration of the form, arrangement, and content of the financial statements</p>	Issuers A and B

**AS 2810, *Evaluating Audit Results***

(including the accompanying notes), encompassing matters such as the terminology used, the amount of detail given, the classification of items in the statements, and the bases of amounts set forth.

Note: According to AS 3101, if the financial statements, including the accompanying notes, fail to disclose information that is required by the applicable financial reporting framework, the auditor should express a qualified or adverse opinion and should provide the information in the report, if practicable, unless its omission from the report is recognized as appropriate by a specific auditing standard.<sup>18</sup>

Footnote to AS 2810.31

<sup>18</sup>

AS 3101.41-.44.