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Report on

2017 Inspection of Jones Simkins LLC
(Headquartered in Logan, Utah)

Issued by the

Public Company Accounting Oversight Board

March 29, 2018

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. 104-2018-073A
(Includes portions of Part II of the full report that were not included in PCAOB Release No. 104-2018-073)

PCAOB Release No. 104-2018-073A

2017 INSPECTION OF JONES SIMKINS LLC

Preface

In 2017, the Public Company Accounting Oversight Board ("PCAOB" or "the Board") conducted an inspection of the registered public accounting firm Jones Simkins LLC ("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 a review of portions of an issuer audit. This review was 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 a firm's system of quality control, those discussions also could eventually be made public, but only to the extent a 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 December 31, 2016. Citations in this report reference the reorganized PCAOB auditing standards.

PROFILE OF THE FIRM[1]

Offices	2 (Logan and Salt Lake City, Utah)
Ownership structure	Limited liability company
Partners / professional staff[2]	9 / 40
Issuer audit clients	1
Lead partners on issuer audit work[3]	1

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1 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.

2 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.

3 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 July 17, 2017 to July 21, 2017.[4]

A. Review of Audit Engagement

The inspection procedures included a review of portions of one issuer audit performed by the Firm. The inspection team identified matters that it considered to be deficiencies in the performance of the work it reviewed.

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 the standards that most directly relate to the deficiencies and do not include all standards that apply 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.

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 conformity with the applicable financial reporting framework and its opinion about whether the issuer had maintained, in all

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[4] 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.

material respects, effective internal control over financial reporting ("ICFR"). In other words, in this audit, the auditor issued an opinion without satisfying its fundamental obligation to obtain reasonable assurance about whether the financial statements were free of material misstatement and the issuer maintained effective ICFR.

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 or that there are undisclosed material weaknesses in ICFR. 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.

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.[5]

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

A.1. Issuer A

(1) the failure, in an audit of ICFR, to perform sufficient procedures to test the design and operating effectiveness of controls over revenue and accounts receivable, and in the financial statement audit, as a result of the unsupported level of reliance on controls, the failure to perform sufficient

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[5] 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.

procedures to test revenue and accounts receivable (AS 2201.39, .42, .44, .50, and .B9; AS 2301.16, .18, and .37; AS 2315.19, .23, and .23A);

(2) the failure, in an audit of ICFR, to perform sufficient procedures to test the design and operating effectiveness of controls over inventory (AS 2201.39, .42, .44, .50, and .B9); and

(3) the failure to perform sufficient procedures to test the existence and valuation of inventory (AS 2501.11; AS 2510.11).

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 set 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. 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) or the risk associated with the control (in the audit of ICFR) 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 audit for which each standard is cited.

PCAOB Auditing Standards	Issuer
AS 2201, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*	A
AS 2301, *The Auditor's Responses to the Risks of Material Misstatement*	A
AS 2315, *Audit Sampling*	A
AS 2501, *Auditing Accounting Estimates*	A
AS 2510, *Auditing Inventories*	A

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 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,[6] 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 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,

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[6] 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.

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.[7]

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

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[7] 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.

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.[8] 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;[9] related firm methodology, guidance, and practices; and possible root causes.

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

[8] 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.

[9] 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.

performance, training, compliance with independence standards, client acceptance and retention, and the establishment of policies and procedures.

END OF PART I

PORTIONS OF THE REST OF THIS REPORT ARE NONPUBLIC AND ARE OMITTED FROM THIS PUBLIC DOCUMENT

PART II

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B. Issues Related to Quality Controls

A firm's system of quality control should provide reasonable assurance of compliance with applicable professional standards and regulatory requirements with respect to its audit practice (QC 20.04 and .17). On the basis of the information reported by the inspection team, including the audit performance deficiencies described in Part II.A (and summarized in Part I.A) and any other deficiencies identified below, the Board has concerns that the Firm's system of quality control fails to provide such reasonable assurance in at least the following respects[10] –

Design and Operation of Quality Control System

Firm Management's Approach to Quality Control

The Firm has a responsibility to ensure that its personnel comply with PCAOB standards in the Firm's issuer audit practice. The Firm's organizational structure, adopted policies, and established procedures should combine to provide the Firm with reasonable assurance of compliance with those standards. (QC 20.03-.04)

In a significant portion of the Firm's audit work reviewed in this inspection, the inspection team identified what it considered to be deficiencies in the performance of the work. The high incidence of such inspection observations is consistent with the incidence of such observations in the most recent previous inspection of the Firm. Moreover, the substance of certain of the observations in this inspection is essentially identical to the substance of observations in the previous inspection, including the observations of deficiencies related to testing the design and operating effectiveness of controls over revenue, accounts receivable, and inventory, and the testing of the

[10] This report's description of quality control issues is based on the inspection team's observations during the primary inspection procedures. Any changes or improvements that the Firm may have made in its system of quality control since that time may not be reflected in this report, but * * * * [have been] taken into account by the Board during its assessment of whether the Firm has satisfactorily addressed the quality control criticisms or defects within the twelve months after the issuance of this report.

existence of inventory. These results indicate that the Firm's management lacks the necessary commitment to an approach to quality control that includes sufficient attention to –

- undertaking only those engagements that are reasonably within the professional competence of the Firm's personnel;

- assigning work on those engagements to persons who have the technical training and proficiency required in the circumstances;

- causing personnel to refer to authoritative literature or other sources and to consult, on a timely basis, with individuals within or outside the firm, when appropriate (for example, when dealing with complex, unusual, or unfamiliar issues);

- providing adequate supervision, including review, by relevant engagement team members, and appropriate performance of engagement quality reviews; and

- implementing personnel management policies and procedures that contribute to personnel having the necessary motivation, and acting with the integrity and objectivity necessary to perform audit work appropriately, with due professional care, including with professional skepticism.

An appropriate approach to those fundamental quality control points should result in far fewer and less significant deficiencies than the inspection teams have regularly observed in reviewing the Firm's work. The Firm should enhance its understanding of each of those points, assess its commitment to them, and, if it intends to continue auditing issuers, implement changes in its policies and procedures necessary to provide reasonable assurance that its practices conform to those points.

* * * *

Engagement Performance

Testing Appropriate to the Audit

The Firm's system of quality control appears not to provide sufficient assurance that the Firm will conduct all testing appropriate to a particular audit, specifically with respect to the following issues:

ICFR

As discussed above, in the audit reviewed, the inspection team identified significant deficiencies related to the Firm's failure to test the design and operating effectiveness of controls over revenue, accounts receivable, and inventory. Similar significant deficiencies were also identified in the Firm's audit of the same issuer that was reviewed in the previous inspection of the Firm (in 2015). Based on review of the work papers and discussions with the engagement personnel, it appeared to the inspection team that the deficiencies identified during the 2017 inspection were attributable, at least in part, to the engagement personnel lacking an appropriate understanding of the PCAOB standard related to auditing ICFR. This information provides cause for concern regarding proficiency of the Firm's engagement personnel with respect to auditing ICFR. [Issuer A]

Existence and Valuation of Inventory

As discussed above, in the audit reviewed, the inspection team identified a significant deficiency related to the Firm's testing of the existence and valuation of inventory. A similar significant deficiency related to the existence of inventory was also identified in the Firm's audit of the same issuer that was reviewed in the previous inspection of the Firm (in 2015). Based on review of the work papers and discussions with the engagement personnel, it appeared to the inspection team that the deficiency identified during the 2017 inspection was attributable, at least in part, to the engagement personnel lacking an appropriate understanding of relevant PCAOB standards. This information provides cause for concern regarding proficiency of the Firm's engagement personnel with respect to auditing inventory. [Issuer A]

Engagement Quality Review

In light of certain audit performance deficiencies described in Part II.A (and summarized in Part I.A), questions exist about the effectiveness of the Firm's system of quality control with respect to the execution of engagement quality reviews in compliance with AS 1220, *Engagement Quality Review*. An engagement quality review performed with due professional care in compliance with AS 1220 should have detected, and resulted in the Firm addressing, the deficiency described in Part II.A related to the Firm's testing of controls over revenue. [Issuer A]

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PCAOB Standards and Rules

The table below lists the specific PCAOB standards and rules that are primarily related to the descriptions of defects in, or criticisms of, the Firm's system of quality control included in this Part of the report.[11]

PCAOB Standards / Rules
AS 1010, *Training and Proficiency of the Independent Auditor*
AS 1015, *Due Professional Care in the Performance of Work*
AS 1220, *Engagement Quality Review*
QC 20, *System of Quality Control for a CPA Firm's Accounting and Auditing Practice*
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[11] This table does not necessarily include reference to every standard or rule that may have been related to the criticisms or potential defects that are included in Part II.

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.[12]

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[12] 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.

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January 26, 2018

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

Re: Response to Part 1 of the Public Company Accounting Oversight Board Draft Report on the 2017 Inspection of Jones Simkins LLC

Dear Ms. Munter

Our response relates to Part 1 of the Public Company Accounting Oversight Board's (PCAOB) Draft Report on the 2017 inspection of Jones Simkins LLC. We believe that the PCAOB's inspection process serves an important role in the achievement of our shared objectives of improving audit quality and serving investors and the public interest. We are committed to continuing to work with the PCAOB to strengthen the audit process.

Our consideration and evaluation of each of the matters set forth in Part 1 of the report addressed steps we considered necessary in the circumstances to adequately consider and comply with AU 390 *Consideration of Omitted Procedures After the Report Date,* and where applicable, AU 561, *Subsequent Discovery of Facts Existing at the Date of the Auditors Report.*

We appreciate the opportunity to formally respond to the Report. We want to reiterate the seriousness with which we view the inspection comments. We remain committed to continual improvement in our audit practice and making responsive changes in areas identified by the PCAOB for improvement.

Sincerely,

Jones Simkins LLC

JONES SIMKINS LLC

PCAOB
Public Company Accounting Oversight Board

APPENDIX A

AUDITING STANDARDS REFERENCED IN PART I

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.

AS 2201, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*		
USING A TOP-DOWN APPROACH		
Selecting Controls to Test		
AS 2201.39	The auditor should test those controls that are important to the auditor's conclusion about whether the company's controls sufficiently address the assessed risk of misstatement to each relevant assertion.	Issuer A
TESTING CONTROLS		
Testing Design Effectiveness		
AS 2201.42	The auditor should test the design effectiveness of controls by determining whether the company's controls, if they are operated as prescribed by persons possessing the necessary authority and competence to perform the control effectively, satisfy the company's control objectives and can effectively prevent or detect errors or fraud that could result in material misstatements in the financial statements. Note: A smaller, less complex company might achieve its control objectives in a different manner from a larger, more complex organization. For example, a smaller, less complex company might have fewer employees in	Issuer A

AS 2201, ***An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements***		
	the accounting function, limiting opportunities to segregate duties and leading the company to implement alternative controls to achieve its control objectives. In such circumstances, the auditor should evaluate whether those alternative controls are effective.	
Testing Operating Effectiveness		
AS 2201.44	The auditor should test the operating effectiveness of a control by determining whether the control is operating as designed and whether the person performing the control possesses the necessary authority and competence to perform the control effectively. Note: In some situations, particularly in smaller companies, a company might use a third party to provide assistance with certain financial reporting functions. When assessing the competence of personnel responsible for a company's financial reporting and associated controls, the auditor may take into account the combined competence of company personnel and other parties that assist with functions related to financial reporting.	Issuer A
Relationship of Risk to the Evidence to be Obtained		
AS 2201.50	*Nature of Tests of Controls*. Some types of tests, by their nature, produce greater evidence of the effectiveness of controls than other tests. The following tests that the auditor might perform are presented in order of the evidence that they ordinarily would produce, from least to most: inquiry, observation, inspection of relevant documentation, and re-performance of a control. Note: Inquiry alone does not provide sufficient evidence to support a conclusion about the effectiveness of a control.	Issuer A

AS 2201, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*		
APPENDIX B – SPECIAL TOPICS		
Integration of Audits		
AS 2201.B9	To obtain evidence about whether a selected control is effective, the control must be tested directly; the effectiveness of a control cannot be inferred from the absence of misstatements detected by substantive procedures. The absence of misstatements detected by substantive procedures, however, should inform the auditor's risk assessments in determining the testing necessary to conclude on the effectiveness of a control.	Issuer A

AS 2301, *The Auditor's Responses to the Risks of Material Misstatement*		
TESTING CONTROLS		
Testing Controls in an Audit of Financial Statements		
AS 2301.16	*Controls to be Tested.* If the auditor plans to assess control risk at less than the maximum by relying on controls,[12] 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 designed effectively and operated effectively during the entire **period of reliance**.[13] However, the auditor is not required to assess control risk at less than the maximum for *all* relevant assertions and, for a variety of reasons, the auditor may choose not to do so.	Issuer A
Footnotes to AS 2301.16 12 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. 13 Terms defined in Appendix A, *Definitions*, are set in **boldface type** the first time they appear.		

AS 2301, *The Auditor's Responses to the Risks of Material Misstatement*		
AS 2301.18	*Evidence about the Effectiveness of Controls in the Audit of Financial Statements*. 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 A
SUBSTANTIVE PROCEDURES		
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 A

AS 2315, *Audit Sampling*		
SAMPLING IN SUBSTANTIVE TESTS OF DETAILS		
Planning Samples		
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	Issuer A

AS 2315, *Audit Sampling*		
	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.[3] Thus, the auditor would select a larger sample size for the tests of details than if he allowed a higher risk of incorrect acceptance.	
Footnote to AS 2315.19 3 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 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.	Issuer A
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 A

AS 2501, *Auditing Accounting Estimates*		
EVALUATING ACCOUNTING ESTIMATES		
Evaluating Reasonableness		
AS 2501.11	Review and test management's process. In many situations, the auditor assesses the reasonableness of an accounting estimate by performing procedures to test the process used by management to make the estimate. The following are procedures the auditor may consider performing when using this approach: a. Identify whether there are controls over the preparation of accounting estimates and supporting data that may be useful in the evaluation. b. Identify the sources of data and factors that management used in forming the assumptions, and consider whether such data and factors are relevant, reliable, and sufficient for the purpose based on information gathered in other audit tests. c. Consider whether there are additional key factors or alternative assumptions about the factors. d. Evaluate whether the assumptions are consistent with each other, the supporting data, relevant historical data, and industry data. e. Analyze historical data used in developing the assumptions to assess whether the data is comparable and consistent with data of the period under audit, and consider whether such data is sufficiently reliable for the purpose. f. Consider whether changes in the business or industry may cause other factors to become significant to the assumptions. g. Review available documentation of the assumptions used in developing the accounting estimates and inquire about any other plans, goals, and objectives of the entity, as well as consider their relationship to the assumptions. h. Consider using the work of a specialist regarding certain assumptions (AS 1210, *Using the Work of a Specialist*). i. Test the calculations used by management to translate the assumptions and key factors into the accounting estimate.	Issuer A

AS 2510, *Auditing Inventories*		
INVENTORIES		
AS 2510.11	In recent years, some companies have developed inventory controls or methods of determining inventories, including statistical sampling, which are highly effective in determining inventory quantities and which are sufficiently reliable to make unnecessary an annual physical count of each item of inventory. In such circumstances, the independent auditor must satisfy himself that the client's procedures or methods are sufficiently reliable to produce results substantially the same as those which would be obtained by a count of all items each year. The auditor must be present to observe such counts as he deems necessary and must satisfy himself as to the effectiveness of the counting procedures used. If statistical sampling methods are used by the client in the taking of the physical inventory, the auditor must be satisfied that the sampling plan is reasonable and statistically valid, that it has been properly applied, and that the results are reasonable in the circumstances.	Issuer A