

**Report on**  
**2018 Inspection of KPMG Auditores, S.L.**  
**(Headquartered in Madrid, Kingdom of Spain)**

**Issued by the**  
**Public Company Accounting Oversight Board**  
**August 27, 2020**

**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**

## **2018 INSPECTION OF KPMG AUDITORES, S.L.**

### Preface

In 2018, the Public Company Accounting Oversight Board ("PCAOB" or "the Board") conducted an inspection of the registered public accounting firm KPMG Auditores, S.L. ("the Firm") pursuant to the Sarbanes-Oxley Act of 2002 ("the Act").<sup>1</sup>

Inspections are designed and performed to provide a basis for assessing the degree of compliance by a firm with applicable requirements related to issuer audit work. 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 two issuer audits performed by the Firm and the Firm's audit work on one other issuer audit engagement in which it played a role but was not the principal auditor. 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 audit work. 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.

---

<sup>1</sup> The Board's inspection was conducted in cooperation with the Accounting and Auditing Institute of Spain.

## PROFILE OF THE FIRM<sup>2</sup>

Offices	17 (Andorra la Vella, Principality of Andorra; and Alicante, Bilbao, A Coruna, Girona, Las Palmas de Gran Canaria, L'Hospitalet de Llobregat, Madrid, Malaga, Oviedo, Palma de Mallorca, Pamplona, San Sebastian, Sevilla, Valencia, Vigo, and Zaragoza, Kingdom of Spain)
Ownership structure	Limited liability company
Partners / professional staff <sup>3</sup>	116 / 3,319
Issuer audit clients	2
Other issuer audits in which the Firm plays a role <sup>4</sup>	36
Lead partners on issuer audit work <sup>5</sup>	30

---

<sup>2</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>3</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>4</sup> The number of other issuer audits encompasses audit work performed by the Firm in engagements for which the Firm was not the principal auditor, including audits, if any, in which the Firm plays a substantial role as defined in PCAOB Rule 1001(p)(ii).

<sup>5</sup> The number of lead partners on issuer audit work represents the total number of Firm personnel or persons who provide professional services on behalf of the Firm (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*

## PART I

### INSPECTION PROCEDURES AND CERTAIN OBSERVATIONS

Members of the Board's staff ("the inspection team") conducted primary procedures for the inspection from October 8, 2018 through October 19, 2018, from November 5, 2018 through November 16, 2018, and from December 10, 2018 through December 20, 2018.<sup>6</sup>

#### A. Review of Audit Engagements

The inspection procedures included reviews of portions of two issuer audits performed by the Firm and the Firm's audit work on one other issuer audit engagement in which it played a role but was not the principal auditor. 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

---

*Engagement*) or for the Firm's role in an issuer audit during the twelve-month period preceding the outset of the inspection.

<sup>6</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.

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/or its opinion about whether the issuer had maintained, in all 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/or 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.<sup>7</sup>

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

#### Issuer A

- (1) the failure, in an audit of ICFR, to perform sufficient procedures to identify and test the design and operating effectiveness of controls, including certain information technology general controls ("ITGCs") that supported the operation of controls over the valuation of certain receivables, including the failure to (a) evaluate the actions performed by the control owners to test certain controls with a review element, (b) identify and test

---

<sup>7</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.

controls over certain assumptions and inputs used by management to estimate the value of certain receivables, and (c) sufficiently evaluate and test certain compensating controls (AS 2201.39, .42, .44, .46, .47, and .68);

(2) the failure to perform sufficient procedures to test the valuation of certain receivables, including the failure to evaluate the reasonableness of certain assumptions used by management to estimate the value of certain receivables (AS 2501.11; AS 2502.26 and .38); and

(3) the failure, in an audit of ICFR, to perform sufficient procedures to identify and test the design and operating effectiveness of controls over the valuation of certain investments, including the failure to (a) identify and test controls over the methods and assumptions used by management to estimate the value of certain investments, and (b) evaluate the actions performed by the control owner in the test of a control with a review element (AS 2201.39, .42, and .44).

The inspection team also identified deficiencies in an audit in which the Firm played a role but was not the principal auditor. Certain deficiencies were of such significance that it appeared to the inspection team that the Firm had not obtained sufficient appropriate audit evidence to fulfill the objectives of its role in the audit. The deficiencies that reached this level of significance are described below—

#### Issuer B

(1) the failure, in connection with the Firm's role in an audit of ICFR, to perform sufficient procedures to identify and test the design and operating effectiveness of controls over the valuation of long-lived assets, including the failure to (a) evaluate the actions performed by the control owner in the test of a control with a review element, and (b) identify and test controls over (i) the accuracy and completeness of data used in the operation of a control, and (ii) certain cash flow projections used by management to estimate the value of long-lived assets (AS 2201.39, .42, and .44); and

(2) the failure to perform sufficient procedures to test the valuation of long-lived assets, including the failure to evaluate the reasonableness of certain assumptions used by management to estimate the value of long-lived assets (AS 2501.11 and .12).

## **B. Auditing Standards**

Each deficiency described above could relate to several applicable provisions of the standards that govern the conduct of audit work. 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 audits for which each standard is cited.

PCAOB Auditing Standards	Issuers
<i>AS 2201, An Audit of Internal Control Over Financial Reporting That is Integrated with An Audit of Financial Statements</i>	A and B
<i>AS 2501, Auditing Accounting Estimates</i>	A and B
<i>AS 2502, Auditing Fair Value Measurements and Disclosures</i>	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 audit work. 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 and the firm's audit work on other issuer audit engagements in which it played a role but was not the principal auditor. 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>8</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 audit work, 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, 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 any 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

---

<sup>8</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.

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>9</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 audit engagements and areas of inspection focus are most often selected on a risk-weighted basis and not randomly. Areas of focus vary among selected audit engagements, 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.

## 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 audit engagements. 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 audit work. Even deficiencies that do not result

---

<sup>9</sup> The discussion in this report of any deficiency observed in a particular audit engagement 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.

in an insufficiently supported audit opinion or a failure to obtain sufficient appropriate audit evidence to fulfill the objectives of its role in an audit may indicate a defect or potential defect in a firm's quality control system.<sup>10</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 audit engagements 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>11</sup> 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 performance and the following eight functional areas (1) tone at the top; (2) practices for partner evaluation, compensation, admission, assignment of responsibilities, and disciplinary actions; (3) independence implications of non-audit services; business ventures, alliances, and arrangements; personal financial interests; and commissions and contingent fees; (4) practices for client acceptance and retention; (5) practices for consultations on accounting, auditing, and SEC matters; (6) the firm's internal inspection program; (7) practices for establishment and communication of audit policies, procedures, and methodologies, including training; and (8) the supervision by the firm's audit engagement teams of the work performed by foreign affiliates.

#### END OF PART I

---

<sup>10</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>11</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.

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 and that response has received careful consideration. 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>12</sup>

---

<sup>12</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.



KPMG Auditores, S.L.  
Pº de la Castellana, 259 C  
28046 Madrid  
Tel +34 91 456 34 00  
Fax +34 91 555 01 32  
www.kpmg.es

Public Company Accounting Oversight Board  
1666 K Street, NW  
Washington, DC 20006  
United States of America

Our ref 2020x02cll3.docx

For the attention of  
Mr. George Botic, Director - Division of  
Registration and Inspections

July 17, 2020

**Response to the Draft report on the 2018 Inspection of KPMG Auditores, S.L.**

Dear Mr. Botic,

We appreciate the opportunity to provide our response to the Public Company Accounting Oversight Board's ("PCAOB") Draft Report on the 2018 Inspection of KPMG Auditores, S.L. dated June 18, 2020 ("Draft Report").

We remain committed to full cooperation with the PCAOB, and to our shared objectives of continually improving audit quality, building confidence in the auditing profession and meeting our responsibilities to investors and other participants in the capital markets system. We believe that the PCAOB's inspection process serves to assist us in identifying areas where we can continue to improve our performance and strengthen our system of audit quality control. We appreciate the professionalism and commitment of the PCAOB staff and value the important role the PCAOB plays in improving audit quality.

We conducted a thorough evaluation of the matters identified in the Draft Report and have taken appropriate actions to address the engagement-specific findings in a manner consistent with PCAOB auditing standards and KPMG policies and procedures.

We remain dedicated to evaluating and improving our system of audit quality controls, monitoring audit quality and implementing changes to our policies and practices in order to enhance audit quality. We understand our responsibility to our stakeholders and remain committed to continuing to work constructively with the PCAOB to improve audit quality and build confidence in the auditing profession in the months and years to come.

Very truly yours,

Hilario Albarracín  
Chairman

Borja Guinea  
Head of Audit

**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>.<sup>13</sup>

<b><i>AS 2201, An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements</i></b>		
<b>USING A TOP-DOWN APPROACH</b>		
<b>Selecting Controls to Test</b>		
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.	Issuers A and B
<b>TESTING CONTROLS</b>		
<b>Testing Design Effectiveness</b>		
AS 2201.42	<p>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.</p> <p>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 the accounting function, limiting opportunities to segregate duties and</p>	Issuers A and B

<sup>13</sup> The text presented in this appendix represents the standards as in effect during the applicable audit period.

<b>AS 2201, An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements</b>		
	<p>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.</p>	
<b>Testing Operating Effectiveness</b>		
AS 2201.44	<p>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.</p> <p>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.</p>	Issuers A and B
<b>Relationship of Risk to the Evidence to be Obtained</b>		
AS 2201.46	<p>For each control selected for testing, the evidence necessary to persuade the auditor that the control is effective depends upon the risk associated with the control. The risk associated with a control consists of the risk that the control might not be effective and, if not effective, the risk that a material weakness would result. As the risk associated with the control being tested increases, the evidence that the auditor should obtain also increases.</p> <p>Note: Although the auditor must obtain evidence about the effectiveness of controls for each relevant assertion, the auditor is not responsible for obtaining sufficient evidence to support an opinion about the effectiveness of each individual control. Rather, the auditor's objective is to express an opinion on the company's internal control over financial reporting overall. This allows the auditor to vary the evidence obtained regarding the effectiveness of individual controls selected for testing based on the risk associated with the individual control.</p>	Issuer A

**AS 2201, An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements**

AS 2201.47	<p>Factors that affect the risk associated with a control include –</p> <ul style="list-style-type: none"> <li>▪ The nature and materiality of misstatements that the control is intended to prevent or detect;</li> <li>▪ The inherent risk associated with the related account(s) and assertion(s);</li> <li>▪ Whether there have been changes in the volume or nature of transactions that might adversely affect control design or operating effectiveness;</li> <li>▪ Whether the account has a history of errors;</li> <li>▪ The effectiveness of entity-level controls, especially controls that monitor other controls;</li> <li>▪ The nature of the control and the frequency with which it operates;</li> <li>▪ The degree to which the control relies on the effectiveness of other controls (<i>e.g.</i>, the control environment or information technology general controls);</li> <li>▪ The competence of the personnel who perform the control or monitor its performance and whether there have been changes in key personnel who perform the control or monitor its performance;</li> <li>▪ Whether the control relies on performance by an individual or is automated (<i>i.e.</i>, an automated control would generally be expected to be lower risk if relevant information technology general controls are effective); and</li> </ul> <p>Note: A less complex company or business unit with simple business processes and centralized accounting operations might have relatively simple information systems that make greater use of off-the-shelf packaged software without modification. In the areas in which off-the-shelf software is used, the auditor's testing of information technology controls might focus on the application controls built into the pre-packaged software that management relies on to achieve its control objectives and the IT general controls that are important to the effective operation of those application controls.</p>	Issuer A
------------	---	----------

<b>AS 2201, An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements</b>		
	<ul style="list-style-type: none"> <li>▪ The complexity of the control and the significance of the judgments that must be made in connection with its operation.</li> </ul> <p style="margin-left: 40px;">Note: Generally, a conclusion that a control is not operating effectively can be supported by less evidence than is necessary to support a conclusion that a control is operating effectively.</p>	
<b>EVALUATING IDENTIFIED DEFICIENCIES</b>		
AS 2201.68	The auditor should evaluate the effect of compensating controls when determining whether a control deficiency or combination of deficiencies is a material weakness. To have a mitigating effect, the compensating control should operate at a level of precision that would prevent or detect a misstatement that could be material.	Issuer A

<b>AS 2501, Auditing Accounting Estimates</b>		
<b>EVALUATING REASONABLENESS</b>		
AS 2501.11	<p>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:</p> <ol style="list-style-type: none"> <li>a. Identify whether there are controls over the preparation of accounting estimates and supporting data that may be useful in the evaluation.</li> <li>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.</li> <li>c. Consider whether there are additional key factors or alternative assumptions about the factors.</li> <li>d. Evaluate whether the assumptions are consistent with each other, the supporting data, relevant historical data, and industry data.</li> <li>e. Analyze historical data used in developing the assumptions to assess whether the data is comparable and consistent with data of the period</li> </ol>	Issuers A and B

<b>AS 2501, Auditing Accounting Estimates</b>		
	<p>under audit, and consider whether such data is sufficiently reliable for the purpose.</p> <p>f. Consider whether changes in the business or industry may cause other factors to become significant to the assumptions.</p> <p>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.</p> <p>h. Consider using the work of a specialist regarding certain assumptions (AS 1210, <i>Using the Work of a Specialist</i>).</p> <p>i. Test the calculations used by management to translate the assumptions and key factors into the accounting estimate.</p>	
AS 2501.12	<p><i>Develop an expectation.</i> Based on the auditor's understanding of the facts and circumstances, he may independently develop an expectation as to the estimate by using other key factors or alternative assumptions about those factors.</p>	Issuer B

<b>AS 2502, Auditing Fair Value Measurements and Disclosures</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> <p>a. Management's assumptions are reasonable and reflect, or are not inconsistent with, market information (see paragraph .06).</p> <p>b. The fair value measurement was determined using an appropriate model, if applicable.</p>	Issuer A

<b>AS 2502, Auditing Fair Value Measurements and Disclosures</b>		
	c. Management used relevant information that was reasonably available at the time.	
AS 2502.38	For items valued by the entity using a valuation model, the auditor does not function as an appraiser and is not expected to substitute his or her judgment for that of the entity's management. Rather, the auditor reviews the model and evaluates whether the assumptions used are reasonable and the model is appropriate considering the entity's circumstances. For example, it may be inappropriate to use discounted cash flows for valuing an equity investment in a start-up enterprise if there are no current revenues on which to base the forecast of future earnings or cash flows.	Issuer A