1666 K Street, N.W.
Washington, DC 20006
Telephone: (202) 207-9100
Facsimile: (202) 862-8433
www.pcaobus.org

# Report on

# 2015 Inspection of Lichter, Yu and Associates, Inc.
**(Headquartered in Encino, California)**

**Issued by the**

## Public Company Accounting Oversight Board

**December 21, 2015**

**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. 104-2016-043A
(Includes portions of Part II of the full report that were not included in PCAOB Release No. 104-2016-043)

# 2015 INSPECTION OF LICHTER, YU AND ASSOCIATES, INC.

## Preface

In 2015, the Public Company Accounting Oversight Board ("PCAOB" or "the Board") conducted an inspection of the registered public accounting firm Lichter, Yu and Associates, Inc. ("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.

## PROFILE OF THE FIRM[1]

| | |
|---|---|
| Offices | 1 (Encino, California) |
| Ownership structure | Professional corporation |
| Partners/professional staff[2] | 2/1 |
| Issuer audit clients | 4 |
| Lead partners on issuer audit work[3] | 2 |

The Firm is a successor to the registration status of Lichter, Yu and Associates, following a PCAOB Form 4 filing in which the Firm reported that it had changed its form of organization while remaining under substantially the same ownership. For purposes of the Board's authority with respect to registered public accounting firms, the Firm has retained or assumed responsibility for the conduct of Lichter, Yu and Associates before the change, and audits performed by the predecessor firm could be within the scope of a Board inspection of the Firm.[4]

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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.

[3] The number of lead partners on issuer audit work represents the total number of Firm personnel who had primary responsibility for an issuer audit (as defined in AS No. 10, *Supervision of the Audit Engagement*) during the twelve-month period preceding the outset of the inspection.

[4] The Firm's filing on PCAOB Form 4 relating to the succession is available at http://pcaobus.org/Registration/rasr/Pages/RASR_Search.aspx.

## PART I

## INSPECTION PROCEDURES AND CERTAIN OBSERVATIONS

Members of the Board's inspection staff ("the inspection team") conducted primary procedures for the inspection from April 20, 2015 to April 24, 2015.[5]

### A. Review of Audit Engagements

The inspection procedures included a review of portions of two 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 relates to auditing an aspect of an issuer's financial statements that the issuer restated after the primary inspection procedures.[6]

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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[5] 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.

[6] The 2015 inspection did not include review of any additional audit work related to the restatement.

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.

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.[7]

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

[7] 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, a departure from Generally Accepted Accounting Principles ("GAAP") that related to a potentially material misstatement in the audited financial statements concerning the accounting for convertible debt (AS No. 14, paragraph 30); and

(2) the failure to perform sufficient procedures to evaluate whether goodwill was impaired (AS No. 14, paragraph 3).

A.2. Issuer B

(1) the failure to perform sufficient procedures to test revenue, including the inadequate performance of analytical procedures (AS No. 12, paragraph 68; AS No. 13, paragraphs 8 and 13; AU 329, paragraphs .17, .20, and .21);

(2) the failure to perform sufficient procedures to test stock-based compensation (AU 328, paragraphs .26 and .28); and

(3) the failure to perform sufficient procedures to test discontinued operations (AS No. 14, paragraphs 30 and 31).

## 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. AU 230, *Due Professional Care in the Performance of Work*, paragraphs .02, .05, and .06, requires the independent auditor to plan and perform his or her work with due professional care and sets forth aspects of that requirement. AU 230, paragraphs .07 through .09, and AS No. 13, *The Auditor's Responses to the Risks of Material Misstatement*, paragraph 7, 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 No. 13, paragraphs 3, 5, and 8, requires the auditor to design and implement audit responses that address the risks of material misstatement, and AS No. 15, *Audit Evidence*, paragraph 4, 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 No. 12, *Identifying and Assessing Risks of Material Misstatement* | B |
| AS No. 13, *The Auditor's Responses to the Risks of Material Misstatement* | B |
| AS No. 14, *Evaluating Audit Results* | A and B |
| AU 328*, Auditing Fair Value Measurements and Disclosures* | B |
| AU 329, *Substantive Analytical Procedures* | 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,[8] as well as a

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[8] 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

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, even if the firm claimed to have performed the procedure. AS No. 3, *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.[9]

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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.

[9] 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

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.

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.[10] 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

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professional standards are not a result of an adversarial adjudicative process and do not constitute conclusive findings for purposes of imposing legal liability.

[10] 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.

nature, significance, and frequency of deficiencies;[11] 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, training, compliance with independence standards, client acceptance and retention, and the establishment of policies and procedures.

END OF PART I

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11 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.

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

The inspection of the Firm included consideration of aspects of the Firm's system of quality control.[12]

B.1. Audit Performance

A firm's system of quality control should provide reasonable assurance that the work performed on an audit engagement will meet applicable professional standards and regulatory requirements. 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 –

B.1.a. 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:

B.1.a.i. Convertible Notes with Beneficial Conversion Features

As discussed above, in one of the audits reviewed, the inspection team identified a significant deficiency related to the Firm's failure to identify, or to address appropriately, a departure from GAAP that related to potentially material misstatements in the audited financial statements concerning the accounting for embedded beneficial

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[12] 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 will be 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.

conversion features in convertible notes. The inspection team attempted to identify apparent or likely causes of this deficiency. Based on review of the work papers and discussions with the engagement personnel, it appeared to the inspection team that this deficiency was attributable, at least in part, to the engagement personnel lacking an adequate understanding of the accounting principles related to convertible notes with beneficial conversion features, including FASB ASC Topic 470. This information provides cause for concern regarding the proficiency of the Firm's engagement personnel with respect to auditing convertible notes with beneficial conversion features. [Issuer A]

B.1.a.ii. Due Care and Professional Skepticism

As discussed above, in both of the audits reviewed, the inspection team reported identifying a total of four audit deficiencies of such significance that they appeared to the inspection team to result in insufficiently supported audit opinions. With respect to each deficiency, based on review of the work papers and discussions with the engagement personnel it appeared to the inspection team that the deficiency was attributable, at least in part, to the engagement personnel having approached that aspect of the audit without due care, including without professional skepticism. This information provides cause for concern about whether the Firm's policies and procedures provide sufficient assurance that the Firm's engagement personnel will perform all aspects of their work on issuer audits with due care, including with professional skepticism, which is an attitude that includes a questioning mind and a critical assessment of audit evidence.

B.1.b. Risk assessment

The Firm's system of quality control appears not to provide sufficient assurance that the Firm will perform all of the required procedures in accordance with the provisions of AS No. 12, *Identifying and Assessing Risks of Material Misstatement.* In both of the audits reviewed, the Firm failed to identify relevant risks of material misstatement at the assertion level. [Issuers A and B]

B.1.c. Engagement Quality Review

In light of the 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 No. 7, *Engagement Quality Review*. An engagement quality review performed with due care in compliance with AS No. 7 should have detected, and resulted in the Firm addressing, each of the deficiencies described in Part II.A. [Issuers A and B]

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## 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.[13]

[13] 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.

LICHTER, YU AND ASSOCIATES, INC.
CERTIFIED PUBLIC ACCOUNTANTS

16133 VENTURA BLVD., SUITE 450
ENCINO, CALIFORNIA 91436
TEL (818)789-0265 FAX (818) 789-3949

September 24, 2015

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

**RE: Response to Draft Report on the April 2015 Inspection of Lichter, Yu and Associates, Inc.**

Dear Ms. Munter:

Thank you very much for your letter dated August 25, 2015 and copy of our Draft Report on Inspection based on your team's inspection of our audit clients completed in April 2015.

We greatly recognize the value of the PCAOB inspection, its process and observations. We continually strive to improve upon our process and audit quality. We have taken, and will take, the Board's observations and comments into consideration as we formulate and design our audit procedures and programs.

We have reviewed each of the observations set forth in Part I – Inspection Procedures and Certain Observations of the Report and have taken appropriate actions under both PCAOB standards and our policies. Our evaluation included those steps that we considered necessary to comply with AU 390, Consideration of Omitted Procedures After the Report Date, and AU 561, Subsequent Discovery of Facts Existing at the Date of the Auditor's Report.

We intend that this letter be included in the report as part of our response. Our responses attached herewith related to the public portion of the report.

Should you have any questions regarding our response please do not hesitate to contact me.

Sincerely,

Lawrence P. Lichter
Senior Partner
Lichter, Yu and Associates, Inc.

**Issuer A**

The Firm failed to perform sufficient procedures to evaluate whether goodwill was impaired.

**Response:**

As written in the response the Firm did document inquiries of management regarding the goodwill and its impairment, and the reasons for not making any impairment adjustment.

The Firm did consider other items in its analysis of Goodwill and the acceptance of management's opinion that Goodwill was not impaired.

We documented and analyzed the fact that the Company had recently completed a capital raise of $400,000 from qualified investors who all invested based on the technology that was acquired by the Company, which created the goodwill. We felt that this was further evidence that there was market belief in the investment community that the Goodwill had enough value to raise $400,000.

This work was performed by was not in the file at the time of our inspection. Since the 45 day file completion date for this issue had not yet ended we have added it to the audit file. The report date was March 26, 2015 and thus the file completion date was May 10, 2015.

**Issuer B:**

The firm failed to perform sufficient procedures to test the valuation of stock options issued during the year.

**Response:**

The overall impact of this comment on the financial statement of the issue was $194,797. The stock options were respectively issued in April 2013, July 2013 and August 2013. Procedures to evaluate the assumptions for the stock options for stock volatilities, expected option term and risk-free rate were all documented in our files for the periods ended June 2013, and September 2013, during which the above dates were reviewed.

Based on the consideration mentioned above, the Firm determined that is has performed sufficient procedures for the valuation of the stock options issued for the year ended June 30, 2014. However, we acknowledge that a notation should have been made in the work papers as well for June 30, 2014.

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 No. 12, *Identifying and Assessing Risks of Material Misstatement*** | | |
|---|---|---|
| **Factors Relevant to Identifying Fraud Risks** | | |
| AS No. 12.68 | *Presumption of Fraud Risk Involving Improper Revenue Recognition.* The auditor should presume that there is a fraud risk involving improper revenue recognition and evaluate which types of revenue, revenue transactions, or assertions may give rise to such risks. | Issuer B |

| **AS No. 13, *The Auditor's Responses to the Risks of Material Misstatement*** | | |
|---|---|---|
| **Responses Involving the Nature, Timing, and Extent of Audit Procedures** | | |
| AS No. 13.8 | The auditor should design and perform audit procedures in a manner that addresses the assessed risks of material misstatement for each relevant assertion of each significant account and disclosure. | Issuer B |
| **RESPONSES TO FRAUD RISKS** | | |
| AS No. 13.13 | *Addressing Fraud Risks in the Audit of Financial Statements.* 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 | Issuer B |

| AS No. 13, *The Auditor's Responses to the Risks of Material Misstatement* | | |
|---|---|---|
| | accordance with paragraphs 16–17 of this standard, the auditor should perform tests of those controls. | |

| AS No. 14, *Evaluating Audit Results* | | |
|---|---|---|
| **Evaluating the Results of the Audit of Financial Statements** | | |
| AS No. 14.3 | In forming an opinion on whether the financial statements are presented fairly, in all material respects, in conformity with the applicable financial reporting framework, the auditor should take into account all relevant audit evidence, regardless of whether it appears to corroborate or to contradict the assertions in the financial statements. | Issuer A |
| **EVALUATING THE PRESENTATION OF THE FINANCIAL STATEMENTS, INCLUDING THE DISCLOSURES** | | |
| AS No. 14.30 | The auditor must evaluate whether the financial statements are presented fairly, in all material respects, in conformity with the applicable financial reporting framework.<br><br>Note: AU sec. 411, *The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles,* establishes requirements for evaluating the presentation of the financial statements. Auditing Standard No. 6, *Evaluating Consistency of Financial Statements,* establishes requirements regarding evaluating the consistency of the accounting principles used in financial statements.<br><br>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. | Issuers A and B |

| AS No. 14, *Evaluating Audit Results* | | |
|---|---|---|
| AS No. 14.31 | 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 (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.<br><br>Note: According to AU sec. 508, 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.[18/] | Issuer B |
| Footnote to AS No. 14.31<br><br>[18/] AU secs. 508.41-.44. | | |

| AU 328, *Auditing Fair Value Measurements And Disclosures* | | |
|---|---|---|
| **Testing Management's Significant Assumptions, the Valuation Model, and the Underlying Data** | | |
| AU 328.26 | 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:<br><br>a. Management's assumptions are reasonable | Issuer B |

| AU 328, *Auditing Fair Value Measurements And Disclosures* | | |
|---|---|---|
| | and reflect, or are not inconsistent with, market information (see paragraph .06).<br>b. The fair value measurement was determined using an appropriate model, if applicable.<br>c. Management used relevant information that was reasonably available at the time. | |
| AU 328.28 | Where applicable, the auditor should evaluate 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. | Issuer B |

| AU 329, *Substantive Analytical Procedures* | | |
|---|---|---|
| **Precision of the Expectation** | | |
| AU 329.17 | The expectation should be precise enough to provide the desired level of assurance that differences that may be potential material misstatements, individually or when aggregated with other misstatements, would be identified for the auditor to investigate (see paragraph .20). As expectations become more precise, the range of expected differences becomes narrower and, accordingly, the likelihood increases that significant differences from the expectations are due to misstatements. The precision of the expectation depends on, among other things, the auditor's identification and consideration of factors that significantly affect the amount being audited and the level of detail of data used to develop the expectation. | Issuer B |
| **Investigation and Evaluation of Significant Differences** | | |
| AU 329.20 | In planning the analytical procedures as a substantive test, the auditor should consider the amount of difference from the expectation that can be accepted without further investigation. This consideration is influenced primarily by materiality and should be consistent with the level of assurance desired from the procedures. | Issuer B |

| **AU 329, *Substantive Analytical Procedures*** | | |
|---|---|---|
| | Determination of this amount involves considering the possibility that a combination of misstatements in the specific account balances, or class of transactions, or other balances or classes could aggregate to an unacceptable amount. | |
| AU 329.21 | 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. (See Auditing Standard No. 14, *Evaluating Audit Results*.) | Issuer B |