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CPA FINANCIAL SERVICES: Audits

The audit is the highest level of assurance service that a CPA performs and is intended to provide a user comfort on the accuracy of financial statements. The CPA performs procedures in order to obtain "reasonable assurance" (defined as a high but not absolute level of assurance) about whether the financial statements are free from material misstatement.

In an audit, a CPA is required to obtain an understanding of a business's internal control and assess fraud risk. The CPA is also required to corroborate the amounts and disclosures included in the financial statements by obtaining audit evidence through inquiry, physical inspection, observation, third-party confirmations, examination, analytical procedures, and other procedures.

When performing an audit engagement, the CPA is required to determine whether his or her independence has been impaired. If the CPA's independence has been impaired, the CPA cannot perform the audit engagement.

The CPA will issue a formal report that expresses an opinion on whether the financial statements are presented fairly, in all material aspects, in accordance with the applicable financial reporting framework. In addition, the CPA is required to report any significant or material weaknesses in the organization's system of internal control that are identified during the audit. By becoming aware of internal control weaknesses and discussing these with the CPA, an organization might be able to improve the way it does business.

As the highest level of assurance, an audit typically is appropriate – and often required – when a client is seeking complex or high levels of financing and credit. An audit also is appropriate if the client is seeking outside investors or preparing to sell or merge with another business.

Adapted from: *Guide to Financial Statement Services: Compilation, Review, and Audit*. AICPA. 2015
AU-C 200: Overall Objectives of the Independent Auditor. AICPA. 2015.
AU-C 240: Consideration of Fraud in a Financial Statement Audit. AICPA. 2015

Key Aspects of an Audit

- Intended to provide creditors, investors, and other outside parties with a high level of comfort on the accuracy of financial statements

- CPA issues a formal report that expresses an opinion on whether the financial statements are presented fairly, in all material aspects, in accordance with the applicable financial reporting framework

- Typically appropriate and often required when seeking high levels of financing or outside investors, or when selling a business

- Seeks to obtain reasonable (defined as high, but not absolute) assurance about whether the financial statements as a whole are free of material misstatement
  - A material misstatement is one where the severity or nature of the difference (i.e., misstatement) would cause a user to form an incorrect conclusion about a financial statement
  - Misstatements can arise from either fraud or error
    - The risk of not detecting a material misstatement resulting from fraud is higher than the risk of not detecting one resulting from error, as fraud may involve sophisticated and carefully organized schemes designed to conceal it (e.g. forgery, deliberate failure to record transactions, collusion, intentional misrepresentations being made to the auditor)
    - An audit is not an official investigation into alleged wrongdoing, and an auditor is not given specific legal powers (such as the power of search) that may be necessary for such an investigation
    - The primary responsibility for the prevention and detection of fraud rests with those charged with governance of the entity and management

- When engaged to perform an audit, a CPA is required to:
  - be independent
  - obtain an understanding of the entity's internal control and assess fraud risk
  - perform inquiry and analytical procedures
  - perform verification and substantiation procedures