

1

AU-C 200 Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Generally Accepted Auditing Standards

Technical Alert	1	Auditor's Objectives	3
Scope	1	Materiality	3
Definitions of Terms	2	Ethical Requirements	3
Objectives of AU-C 200	2	Professional Judgment and Skepticism	4
Requirements	2	Complying with GAAS	5
Management's Responsibilities	2	GAAS and the GAAS Hierarchy	6

TECHNICAL ALERT

Recently issued SAS 146 affects AU-C 200. The preface to this volume contains an overview of the SAS, and the changes are noted in this chapter.

SCOPE

AU-C 200 describes:

- The auditor's overall responsibilities when conducting a GAAS audit, including
 - The auditor's overall objectives,
 - The nature and scope of the audit, and
 - The scope, authority, and structure of GAAS.

(AU-C 200.01)

DEFINITIONS OF TERMS

Source: AU-C 200.14. For definitions related to this standard, see Appendix A, “Definitions of Terms”: Applicable financial reporting framework, Audit evidence, Audit risk, Auditor, Detection risk, Financial reporting framework, Financial statements, Historical financial information, Interpretive publications, Management, Misstatement, Other auditing publications, Premise, relating to the responsibilities of management and, when appropriate, those charged with governance, on which an audit is conducted (the premise), Professional judgment, Professional skepticism, Reasonable assurance, Risk of material misstatement, Those charged with governance.

OBJECTIVES OF AU-C 200

The overall objectives of the auditor, in conducting an audit of financial statements, are to:

- a. *get reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are presented fairly, in all material respects, in accordance with an applicable financial reporting framework; and*
- b. *report on the financial statements, and communicate as required by GAAS, in accordance with the auditor’s findings.*

(AU-C 200.12)

If the auditor cannot get reasonable assurance and a qualified opinion is insufficient, the auditor must either:

- Disclaim an opinion or
- Withdraw from the engagement when possible under applicable law or regulation.

(AU-C 200.13)

REQUIREMENTS

MANAGEMENT’S RESPONSIBILITIES

Financial statements are prepared by management with oversight from those charged with governance. GAAS do not *impose* requirements on management or those charged with governance, but rather an audit is conducted on the premise that management and those charged with governance *understand* their responsibilities. (AU-C 200.05)

Many times clients do not understand their responsibilities for audited financial statements. The financial statements are *management’s*. They contain management’s representations. The form and content of the financial statements are management’s responsibility, even if the auditor prepared them or took part in their preparation. Management also is responsible for designing, implementing, and maintaining an effective system of internal control. (See Appendix A, definition of premise.)

AUDITOR'S OBJECTIVES

The purpose of an audit of financial statements is confined to the expression of an opinion on the financial statements being audited. In performing the audit, the auditor is responsible for compliance with GAAS. (AU-C 200.04)

MATERIALITY

In every audit, the auditor has to get reasonable assurance¹ about whether the financial statements are free of material misstatement, whether due to errors or to fraud. (AU-C 200.06) Materiality is considered when planning and performing the audit. Misstatements are material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.² However, the auditor is not required to get reasonable assurance that misstatements not material to the financial statements taken as a whole, whether caused by fraud or error, are detected. Materiality considers qualitative and quantitative elements and should be viewed in context. (AU-C 200.07)

ETHICAL REQUIREMENTS

The auditor has a responsibility to consider GAAS in all audits. For more information, see the section "Complying with GAAS" later in this chapter.

To provide reasonable assurance that it is conforming with generally accepted auditing standards in its audit engagements, an accounting firm should establish quality control policies and procedures. These policies and procedures should apply not only to audit engagements but also to attest any accounting and review services for which professional standards have been established. (AU-C 200.A20) The AICPA's Quality Control Standards detail the firm's responsibility for establishing and maintaining a system of quality control for auditors.³ See QC Section 10, *A Firm's System of Quality Control*, for more information.⁴

The auditor must be independent. If not independent, the auditor cannot issue a report under GAAS. The only exception is if GAAS provides otherwise or law or regulation requires the auditor to accept the engagement and report on the financial statements. (AU-C 200.15) In that situation, AU-C 705, *Modifications to the Opinion in the Independent Auditor's Report*, applies.

To be *independent*, the auditor must be intellectually honest; to be *recognized* as independent, he or she must be free from any obligation to or interest in the client, its management, or its owners. The auditor should be independent in appearance as well as fact. (AU-C 200.A17) For specific guidance, the auditor should look to the AICPA and the state society codes of conduct and, if relevant, the Securities and Exchange Commission (SEC). (AU-C 210.A21)

¹ See Appendix A, *Definitions of Terms*.

² This definition of materiality is aligned with that of the IASB and the IAASB, and the description used by the U.S. judicial system, the PCAOB, the SEC, and the FASB.

³ Upon implementation of SAS 146, this sentence becomes: *A Firm's System of Quality Management sets out the firm's responsibilities to design, implement, and operate a system of quality management. Such a system gives the firm reasonable assurance that the firm and its personnel fulfill their responsibilities according to professional standard and applicable legal and regulatory requirements and conduct engagements according to those standards and requirements. SQMS 1 details the engagement partner's responsibility for the firm meeting ethical requirements, including independence.*

⁴ Upon implementation of SAS 146, this reference becomes *Statement on Quality Management Standards (SQMS) No.1, A Firm's System of Quality Management.*

4 *AU-C 200 Overall Objectives of the Independent Auditor and the Conduct of an Audit*

Policies and procedures should provide reasonable assurance that personnel maintain independence when required and perform all responsibilities with integrity, objectivity, and due care.

1. Independence is an impartiality that recognizes an obligation for fairness.
2. Integrity pertains to being honest and candid, and requires that service and public trust not be subordinated to personal gain.
3. Objectivity is a state of mind that imposes an obligation to be impartial, intellectually honest, and free of conflicts of interest.
4. Due care requires the auditor to discharge professional responsibilities with the competence and diligence necessary to perform the audit and issue an appropriate report and to render services promptly, thoroughly, and carefully, while observing applicable standards. (AU-C 200.A19)

(AU-C 200.A16)

(See the AICPA's Code of Professional Conduct, ET.0.300.)

PROFESSIONAL JUDGMENT AND SKEPTICISM

Professional Judgment

The auditor must exercise professional judgment in planning and performing an audit of financial statements. (AU-C 200.17-18) The auditor should:

- Observe GAAS,
- Possess the degree of skill commonly possessed by other auditors, and
- Exercise that skill with reasonable care and diligence.

Professional judgment is developed through training and experience. It will come into play in all aspects of the audit, particularly when:

- Assigning materiality,
- Assessing audit risk,
- Evaluating the sufficiency of audit evidence,
- Evaluating management's integrity and judgment, and
- Arriving at conclusions.

(AU-C 200.A28)

As seen from the above list, auditors should exercise professional judgment throughout the audit.

Professional Skepticism

The auditor should also exercise professional skepticism; that is, an attitude that includes a questioning mind and a critical assessment of audit evidence.

In practice, this means that auditors should be alert for:

- Contradictory evidence,
- Indications of fraud,
- Unusual circumstances and those that suggest the need for additional audit procedures,
- Evidence that calls into question the reliability of documents and responses to inquiries,
- The possibility of collusion when performing the audit, and
- How management may override controls in a way that would make the fraud particularly difficult to detect.

(AU-C 200.A22-.A23)

However, the auditor is not an insurer, and the audit report does not constitute a guarantee. It is based on *reasonable assurance*. Thus, it is possible that an audit conducted in accordance with GAAS may not detect a material misstatement.

Auditor's biases, whether conscious or unconscious, may affect professional skepticism and judgment. Those biases may affect the design and performance of procedures and the evaluation of audit evidence. Here are examples of some biases:

- Availability—events or experiences that come to mind or are readily available
- Confirmation—items that affirm an existing belief rather than contradict an existing belief
- Overconfidence—overestimating one's ability to make accurate risk assessments or other judgments
- Anchoring—using an initial piece of information to assess inadequately subsequent information
- Automation—favoring information generated by automated systems even when there are questions about its reliability or usefulness

(AU-C 500.A27)

Sufficient Appropriate Audit Evidence and Audit Risk

In order to form an opinion, the auditor must get reasonable assurance. The auditor gets reasonable assurance by obtaining sufficient appropriate audit evidence to reduce audit risk to an acceptably low level to draw a reasonable conclusion. See Appendix A for the definition of audit evidence. (AU-C 200.19)

COMPLYING WITH GAAS

Auditors must comply with and understand relevant AU-C sections. Relevant sections are those that are in effect and address the circumstances of the audit. (AU-C 200.20 and .21) GAAS uses two categories of professional requirements to describe the degree of responsibility the standards impose on auditors.

1. *Unconditional requirements.* The auditor is required to comply with an unconditional requirement in all cases in which the circumstances exist to which the unconditional requirement applies. SASs use the word "*must*" to indicate an unconditional requirement.
2. *Presumptively mandatory requirements.* The auditor is also required to comply with a presumptively mandatory requirement in all circumstances where the presumptively mandatory requirement exists and applies. However, in rare circumstances, the auditor may depart from a presumptively mandatory requirement. The departure should only relate to a specific procedure when the auditors determine that the procedure would be ineffective in the specific circumstances. The auditors must document their justification for the departure and how the alternative procedures performed in the circumstances were sufficient to achieve the objectives of the presumptively mandatory requirement. GAAS uses the word *should* to indicate a presumptively mandatory requirement.

(AU-C 200.25–.26)

The term *should consider* means that the consideration of the procedure or action is presumptively required, whereas carrying out the procedure or action is not.

6 AU-C 200 Overall Objectives of the Independent Auditor and the Conduct of an Audit

AU-C Section 200 also clarifies that explanatory material is intended to explain the objective of the professional requirements, rather than impose a professional requirement for the auditor to perform. (AU-C 200.A66)

GAAS AND THE GAAS HIERARCHY

The auditor is responsible for planning, conducting, and reporting the results of an audit according to GAAS.⁵ GAAS provide the standards for the auditors' work in fulfilling their objectives. Each AU-C section contains objectives that provide a link between the requirements and the overall objectives of the auditors. Auditors should have sufficient knowledge of the AU-C sections to determine when they apply, and should be prepared to justify departures from them.

Interpretive Publications

Interpretive publications are not auditing standards, but are recommendations, issued under the authority of the ASB, on how to apply GAAS in specific circumstances, including engagements for entities in specialized industries. Interpretive publications comprise:

- Auditing Interpretations of AU-C sections, listed in each chapter of this book that has a related Interpretation.
- AICPA Audit and Accounting Guides and Statements of Position, listed in Appendix B of this book.

(AU-C 200.A86)

Auditors should consider interpretive publications that apply to their audits.

Other Auditing Publications

Other auditing publications, listed in Appendix C of this book, are not authoritative but may help auditors to understand and apply GAAS. An auditor should evaluate such guidance to determine whether it is both (1) *relevant* for a particular engagement and (2) *appropriate* for the particular situation. When evaluating whether the guidance is appropriate, the auditor should consider whether the publication is recognized as helpful in understanding and applying SASs, and whether the author is recognized as an auditing authority. AICPA auditing publications that have been reviewed by the AICPA Audit and Attest Standards staff are presumed to be appropriate. (AU-C 200.A87–.A89)

⁵ Generally accepted auditing standards are issued in the form of Statements on Auditing Standards and codified into AU-C sections in the AICPA's Professional Standards.