


Auditing Operations & Completing the Audit CHAPTER 16	Auditor's Reports CHAPTER 17
	
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Auditing Operations and Completing the Audit

Chapter 16

Relationships Between Balance Sheet and Income Statement Accounts

Balance Sheet Item	Revenue	Expenses
Accounts receivable	Sales	Uncollectible accounts
Notes receivable	Interest, Interest, dividends, gains, investee's income	Uncollectible notes
Securities and investments		Losses
Inventories		Purchases, cost of goods sold, payroll
Property, plant and equip.	Rent, gains	Depreciation; repairs
Intangible assets	Royalties	Amortization
Prepaid expenses		Various expenses
Accrued liabilities		Various expenses
Interest-bearing debt		Interest

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Substantive Tests for Selling, General and Administrative Expenses

- Perform analytical procedures
 - Develop an expectation of the account balance
 - Determine the amount of difference from the expectation that can be accepted without investigation
 - Compare the company's account balance with the expected account balance
 - Investigate significant deviations from the expected account balance
- Obtain or prepare analyses of selected expense accounts
- Obtain or prepare analyses of critical expenses in the income tax return

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Audit Procedures Completed Near the End of Field Work

- Search for unrecorded liabilities
- Review the minutes of meetings
- Perform final analytical procedures
- Perform procedures to identify loss contingencies
- Perform the review for subsequent events
- Obtain the representation letter

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Loss Contingencies

Letters of audit inquiry to client attorneys

- Use detail of "legal expense" to identify the attorneys to send to
- Must receive response once sent
- Must dispose of each matter raised in their response
- Their response must be dated near the date of audit report.

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Procedures to Identify Subsequent Events

- Review latest available financial statements and minutes of the board and selected committees
- Inquiry about matters dealt with at meetings for which minutes are not available
- Inquiry of management
- Obtain lawyer's letter
- Obtain representations from management

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Required Communication With the Audit Committee

- Fraudulent or illegal acts
- Significant deficiencies in internal control (Reportable Conditions)- If material weakness disclose
- The auditors' responsibilities for the audit and other information included with the financial statements
- Significant audit adjustments made
- Proposed audit adjustments evaluated by management as immaterial= summary of uncorrected misstatements
- Information regarding management's selection of accounting principles
- Information regarding significant accounting estimates made by management
- Disagreements with management or other difficulties
- The auditors' viewpoint on an accounting or auditing matter if management contacted other auditors about the matter
- A discussion of the quality of accounting principles and estimates

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Communication of Control Related Matters

Auditors are required to communicate **material weaknesses** and **significant deficiencies** to the audit committee:

A **material weakness** is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

A **significant deficiency** is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

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Auditor's Report

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Independent Auditors' Report
To the Board of Directors and Stockholders of ABC Company:

Non-Public Co. Audit Opinion

We have audited the accompanying consolidated financial statements of ABC Company and its subsidiaries, which comprise the consolidated balance sheet as of December 31, 20X1, and the related consolidated statements of income, changes in stockholders' equity and cash flows for the year then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statement

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statement. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. Our audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of ABC Company and its subsidiaries as of December 31, 20X1, and the results of their operations and their cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Phoenix, Arizona
February 5, 20X2

Williams & Co., LLP

What's an audit? Public

Report of Independent Registered Public Accounting Firm

We have audited the accompanying consolidated balance sheets of BOBS MONEY MAKER Corporation and subsidiaries (the Company) as of December 31, 2004 and 2003, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2004. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of BOBS MONEY MAKER Corporation and subsidiaries as of December 31, 2004 and 2003, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2004, in conformity with accounting principles generally accepted in the United States.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of BOBS MONEY MAKER internal control over financial reporting as of December 31, 2004 based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 10, 2005 expressed an unqualified opinion on management's assessment of, and the effective operation of, internal control over financial reporting.

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Conditions Required for Issuance of an Unqualified Report

The financial statements are presented in conformity with GAAP, including adequate disclosure.

- The audit was performed in accordance with GAAS, and there were no significant scope limitations.

DEVIATION FROM THE ABOVE RESULTS IN ONE OF THE FOLLOWING:

- Unqualified Opinion with Explanatory Paragraph
- Qualified Opinion
- Adverse Opinion
- Disclaimer of Opinion

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BRIEF SUMMARY OF EACH

Unqualified with Explan. Paragraph:

- S'all good, but GAAP did something stupid
- Could be due to a going concern issue
- Auditor wishes to emphasize a matter

Qualified Opinion:

- Statements are GAAP "except for" some item which does not cause overall F/S presentation to be misleading
- Requires explanatory paragraph
- Could include minor scope limitations
- Requires effects of departure to be disclosed

Adverse Opinion:

- Opinion is that the statements are NOT in accordance with GAAP
- Why bother- just telling the user that there was not an opinion

Disclaimer Opinion:

- Similar to Adverse, the auditor is NOT opining, but due to a scope limitation

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Explanatory Paragraph--Going Concern Problem

The accompanying financial statements have been prepared assuming that [America West Airlines, Inc.] will continue as a going concern. As discussed in note 1 to the financial statements, the Company filed a voluntary petition seeking to reorganize under chapter 11 of the federal bankruptcy laws. This event and circumstances relating to this event, including the Company's significant losses, accumulated deficit, and highly leveraged capital structure, **raise substantial doubt about its ability to continue as a going concern.** Although the Company is currently operating as debtor-in-possession under the jurisdiction of the Bankruptcy Court, the continuation of the business as a going concern is contingent upon, among other things, the ability to (1) formulate a Plan of Reorganization which will gain approval of the creditors and stockholders and confirmation of the Bankruptcy Court, (2) maintain compliance with all debt covenants under the debtor-in-possession financing agreements, (3) achieve satisfactory levels of future operating results and cash flows, and (4) obtain additional debt and equity. The accompanying financial statements do not include and adjustments that might result from the outcome of these uncertainties.

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Explanatory Paragraphs--Consistency


As discussed in the Notes to the consolidated financial statements, effective January 1, 2001, the Company [McDonald's Corporation] changed its method for accounting for derivative financial instruments to conform with SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities.

As discussed in Note 15, effective January 1, 2002, the Company changed its method of accounting for goodwill and intangible assets upon adoption of Statement of Financial Accounting Standards (SFAS) No. 142, "Goodwill and Other Intangible Assets."

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Example of a Qualified Report-- Departure from GAAP (Introductory and Scope Paragraphs are Standard)

Basis for Qualified Opinion

The Company has excluded from property and debt in the accompanying balance sheet certain lease obligations that, in our opinion, should be capitalized in order to conform with generally accepted accounting principles. If these lease obligations were capitalized, property would be increased by \$_____, long-term debt by \$_____, and retained earnings by \$_____ as of December 31, 20X1, and net income and earnings per share would be increased (decreased) by \$_____ and \$_____, respectively, for the year then ended.

Qualified Opinion

In our opinion, **except for the effects of not capitalizing lease obligations**, as discussed in the preceding paragraph, the financial statements referred to above present fairly, in all material respects, the financial position of XYZ Company as of December 31, 20X1, and the results of its operations and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

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Example of a Qualified Report--Scope Limitation Standard Introductory Paragraph

Except as discussed in the following paragraph, we conducted our audit...


Basis for Qualified Opinion

We were unable to obtain audited financial statements supporting the Company's investment in a foreign affiliate stated at \$_____, or its equity in earnings of that affiliate of \$_____, which is included in net income, as described in Note 8 to the financial statements; nor were we able to satisfy ourselves as to the carrying value of the investment in the foreign affiliate or the equity in earnings by other auditing procedures.

Qualified Opinion

In our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had we been able to examine evidence regarding the foreign affiliate investment and earnings, the financial statements referred to above present fairly,...

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Adverse Opinion

Adverse Opinion

In our opinion, because of the effects of the matters discussed in the preceding paragraph, the financial statements referred to above **do not present fairly**, in conformity with accounting principles generally accepted in the United States of America, the financial position of XYZ Company as of December 31, 20X5, or the results of its operations or its cash flows for the year then ended.

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Disclaimer of Opinion

We were engaged...

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on conducting the audit in accordance with auditing standards generally accepted in the United States of America. Because of the matter described in the Basis for Disclaimer of Opinion paragraph, however, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for Disclaimer of Opinion

We were unable to obtain audited financial statements supporting the Company's investment in a foreign affiliate stated at \$20,500,000, or its equity in earnings of that affiliate of \$6,250,450, which is included in net income, as described in Note 8 to the financial statements; nor were we able to satisfy ourselves as to the carrying value of the investment in the foreign affiliate or the equity in earnings by other auditing procedures.

Disclaimer of Opinion

Because of the significance of the matter described in the Basis for Disclaimer of Opinion paragraph, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, we do not express an opinion on these financial statements.

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Placement of Explanatory Paragraphs

- Before opinion paragraph
 - Qualified opinions
 - Disclaimers
 - Adverse opinions
- Following opinion paragraph
 - Consistency
 - Substantial doubt about continued existence

OPINIONS SUMMARIZED

	UNQUALIFIED	QUALIFIED GAAP DEPARTURE	QUALIFIED SCOPE LIMIT.	GOING CONCERN/ OR CONSISTENCY	ADVERSE	DISCLAIMER
INTRO	Standard	Standard	Standard	Standard	Standard	"We were engaged to"
SCOPE	Standard	Standard	Except as explained in the following paragraph ...	Standard	Standard	Delete- no scope paragraph
EXPLAN. BEFORE	NA	Description & Quantify effect	Description & Quantify value of item not audited	NA	Describe Reason	Describe Reason
OPINION	Standard	"Except For... present fairly"	Except as might have been determined if...	Standard	"Do NOT present fairly	"We do NOT express an opinion..."
EXPLAN AFTER	NA	NA	NA	Brief Description	NA	NA

ALWAYS UPDATE HEADERS TO PARAGRAPHS (I.E. ADD "QUALIFIED" TO OPINION IF ITS QUALIFIED, DISCLAIMER IF DISCLAIMED ETC.

Shared Responsibility Report

[Standard introductory paragraph language] *We did not audit the financial statements as and for the year ended December 31, 2001 of Glendo, Inc., which statements reflect total sales constituting 27 percent of total consolidated sales for 2001. Those statements were audited by other auditors whose reports have been furnished to us, and our opinion, insofar as it relates to data included for Glendo, Inc. for 2001, is based solely on the report of the other auditors.*

[Standard scope paragraph language] We believe that our audits *and the reports of other auditors* provide a reasonable basis for our opinion.

In our opinion, *based on our audits and the reports of other auditors,* ...

Responsibility for Other Information with the Financial Statements

- FASB or GASB-Required Supplementary Information--The auditors have a responsibility to perform limited procedures on the information for compliance with the applicable FASB or GASB Statements and modify their report to indicate when the information is not presented, not appropriately presented, or the auditors were not able to complete the limited procedures.
- Other Information in Client-Prepared Documents--The auditors have a responsibility to read the information for inconsistencies with other information known to the auditors and for material misstatements, and to consider modifying their report, withholding the use of their report, or withdrawing from the engagement if the client refuses to revise any misstated information.
- Information Accompanying Financial Statements in Auditor-Submitted Documents--The auditors have a responsibility to report on all information in documents prepared or submitted by them.

Independent Auditors' Report

The Board of Directors
A Company, Inc.:

We have audited the accompanying balance sheets of A Company, Inc. as of December 31, 20X2 and 20X1, and the related statements of income, stockholders' equity and comprehensive income, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of A Company, Inc. as of December 31, 20X2 and 20X1, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Our audits were made for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplementary information included in Schedules I through 5 is presented for purposes of additional analysis and is not a required part of the basic financial statements.⁽¹⁾ Such information has been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.⁽²⁾

(signed) FIRM

February 2, 20X3

References: AU 551.06 and 551.12.

EXAMPLE REPORT - SUPPLEMENTARY INFORMATION ATTACHED

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RECENTLY ADDED

If it is an audit of a public company, then the heading is:

“Report of **Registered** Public Accounting Firm”

SUMMARY OF OTHER RELEVANT DIFFERENCES RECAP:
 Scope: Refers to Standards of the PCAOB (vs. GAAS for non-public)
 Fourth Paragraph: Added to opine on design and operating effectiveness of controls over financial reporting.

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