Report on

2018 Inspection of BDO East Coast Partnership
(Headquartered in Sydney, Commonwealth of Australia)

Issued by the

Public Company Accounting Oversight Board

September 25, 2019

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. 104-2019-123
2018 INSPECTION OF BDO EAST COAST PARTNERSHIP

Preface

In 2018, the Public Company Accounting Oversight Board ("PCAOB" or "the Board") conducted an inspection of the registered public accounting firm BDO East Coast Partnership ("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 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 one issuer audit performed by the Firm and the Firm's audit work on two other issuer audit engagements 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.

1 The Board's inspection was conducted in cooperation with the Australian Securities and Investments Commission.
## PROFILE OF THE FIRM

<table>
<thead>
<tr>
<th>Description</th>
<th>Details</th>
</tr>
</thead>
<tbody>
<tr>
<td>Offices</td>
<td>2 (Melbourne and Sydney, Commonwealth of Australia)</td>
</tr>
<tr>
<td>Ownership structure</td>
<td>Partnership</td>
</tr>
<tr>
<td>Partners / professional staff</td>
<td>35 / 367</td>
</tr>
<tr>
<td>Issuer audit clients</td>
<td>1</td>
</tr>
<tr>
<td>Other issuer audits in which the Firm plays a role</td>
<td>5</td>
</tr>
<tr>
<td>Lead partners on issuer audit work</td>
<td>4</td>
</tr>
</tbody>
</table>

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2 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.

3 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.

4 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).

5 The number of lead partners on issuer audit work represents the total number of Firm personnel (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 Engagement) or for the Firm's role in an issuer audit during the twelve-month period preceding the outset of the inspection.
PART I

INSPECTION PROCEDURES AND CERTAIN OBSERVATIONS

Members of the Board's staff ("the inspection team") conducted primary procedures for the inspection from April 13, 2018 to April 20, 2018 and on April 25, 2018.6

A. Review of Audit Engagements

The inspection procedures included reviews of portions of one issuer audit performed by the Firm and the Firm's audit work on two other issuer audit engagements 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.

One of the deficiencies identified was 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 conformity with the applicable financial reporting framework. In other words, in this audit, the auditor issued an opinion without

6 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.
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 deficiency that reached this level of significance is described below.

Issuer A

the failure to perform sufficient procedures to test the occurrence and
valuation of revenue (AS 2301.08, .13, and .17).

The inspection team also identified deficiencies in two audits 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 these audits.
The 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.
Issuer B

(1) the failure, in connection with its role in an audit of an issuer's internal control over financial reporting ("ICFR"), to sufficiently test the design and operating effectiveness of controls over the occurrence, completeness, and valuation of revenue (AS 2201.39, .42, .44, and .B29);

(2) the failure to perform sufficient procedures to test the occurrence, completeness, and valuation of revenue, including the inadequate performance of substantive analytical procedures (AS 2301.13; AS 2305.05, .16, and .21);

(3) the failure, in connection with its role in an audit of an issuer's ICFR, to sufficiently test the design and operating effectiveness of controls over the valuation of inventory (AS 2201.39); and

(4) the failure to perform sufficient procedures to test the valuation of inventory (AS 2501.12).

Issuer C

(1) the failure, in connection with its role in an audit of an issuer's ICFR, to sufficiently test the design and operating effectiveness of controls over the occurrence of revenue (AS 2201.42, .44, and .B29);

(2) the failure to perform sufficient procedures to test the occurrence of revenue, including the inadequate performance of substantive analytical procedures (AS 2301.08 and .13; AS 2305.21); and

(3) the failure, in connection with its role in an audit of an issuer's ICFR, to sufficiently test the design and operating effectiveness of controls over the existence and completeness of inventory and in the audit of financial statements, as a result of the unsupported level of reliance on controls, the failure to perform sufficient procedures to test the existence of inventory (AS 2201.39; AS 2510.11).

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) 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.

<table>
<thead>
<tr>
<th>PCAOB Auditing Standards</th>
<th>Issuers</th>
</tr>
</thead>
<tbody>
<tr>
<td>AS 2301, <em>The Auditor's Responses to the Risks of Material Misstatement</em></td>
<td>A, B, and C</td>
</tr>
</tbody>
</table>
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, 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 concluded that the available evidence does not support the contention that the firm sufficiently performed the necessary work.

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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 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.
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.\(^9\)

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 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

\(^9\) 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.
defect or potential defect in a firm's quality control system.\textsuperscript{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 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;\textsuperscript{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 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

\textsuperscript{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.

\textsuperscript{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.
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.\textsuperscript{12}

\textsuperscript{12} 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.
Mr George Botic  
Director  
Division of Registrations and Inspections  
Public Company Accounting Oversight Board  
1666 K Street NW  
Washington, DC 20006  

20 July 2019

Dear Mr Botic

RESPONSE TO PART I DRAFT REPORT OF BDO EAST COAST PARTNERSHIP

We are pleased to provide our response to Part I of the Public Company Accounting Oversight Board’s (‘PCAOB’) draft report issued on 21 June 2019 on the 2018 Inspection of BDO East Coast Partnership (the ‘Draft Report’).

We have evaluated each of the matters described in Part I of the Draft Report and have taken appropriate actions under both PCAOB standards and our policies, including steps we considered necessary to comply with AS 2901, Consideration of Omitted Procedures After the Report Date, and where applicable, AS 2905, Subsequent Discovery of Facts Existing at the Date of the Auditor’s Report.

We remain committed to making audit quality our top priority. The PCAOB’s inspection process assists us in improving our audit performance and our underlying quality control systems. We look forward to continuing to work with the PCAOB on the most effective means of achieving this objective.

Respectfully submitted

BDO East Coast Partnership

[Signature]

Ian Hooper  
Partner
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.\(^\text{13}\)

<table>
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<tbody>
<tr>
<td><strong>USING A TOP-DOWN APPROACH</strong></td>
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<tr>
<td><strong>Selecting Controls to Test</strong></td>
</tr>
<tr>
<td><strong>AS 2201.39</strong></td>
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<tr>
<td><strong>TESTING CONTROLS</strong></td>
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<tr>
<td><strong>Testing Design Effectiveness</strong></td>
</tr>
<tr>
<td><strong>AS 2201.42</strong></td>
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</table>

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

\(^{13}\) The text presented in this appendix represents the standards as in effect during the applicable audit period.

<table>
<thead>
<tr>
<th>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.</th>
</tr>
</thead>
</table>

**Testing Operating Effectiveness**

<table>
<thead>
<tr>
<th>AS 2201.44</th>
<th>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.</th>
</tr>
</thead>
<tbody>
<tr>
<td>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.</td>
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</tbody>
</table>

**APPENDIX B - Special Topics**

**BENCHMARKING OF AUTOMATED CONTROLS**

<table>
<thead>
<tr>
<th>AS 2201.B29</th>
<th>If general controls over program changes, access to programs, and computer operations are effective and continue to be tested, and if the auditor verifies that the automated application control has not changed since the auditor established a baseline (i.e., last tested the application control), the auditor may conclude that the automated application control continues to be effective without repeating the prior year’s specific tests of the operation of the automated application control. The nature and extent of the evidence that the auditor should obtain to verify that the control has not changed may vary depending on the circumstances, including depending on the strength of the company’s program change controls.</th>
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</thead>
</table>

Issuers B and C
### AS 2301, *The Auditor’s Responses to the Risks of Material Misstatement*

<table>
<thead>
<tr>
<th>RESPONSES INVOLVING THE NATURE, TIMING, AND EXTENT OF AUDIT PROCEDURES</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>AS 2301.08</td>
<td>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. Issuers A and C</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Responses to Fraud Risks</th>
<th></th>
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</thead>
<tbody>
<tr>
<td>AS 2301.13</td>
<td><em>Addressing Fraud Risks in the Audit of Financial Statements.</em> 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 accordance with paragraphs .16-.17 of this standard, the auditor should perform tests of those controls. Issuers A, B, and C</td>
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</table>

<table>
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<tr>
<th>TESTING CONTROLS</th>
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<tbody>
<tr>
<td>Testing Controls in an Audit of Financial Statements</td>
<td></td>
</tr>
<tr>
<td>AS 2301.17</td>
<td>Also, tests of controls must be performed in the audit of financial statements for each relevant assertion for which substantive procedures alone cannot provide sufficient appropriate audit evidence and when necessary to support the auditor's reliance on the accuracy and completeness of financial information used in performing other audit procedures. Issuer A</td>
</tr>
</tbody>
</table>

Note: When a significant amount of information supporting one or more relevant assertions is electronically initiated, recorded, processed, or reported, it might be impossible to design effective substantive tests that, by themselves, would provide sufficient appropriate evidence regarding the assertions. For such assertions, significant audit evidence may be available only in electronic form. In such cases, the sufficiency and appropriateness of the audit evidence usually depend on the effectiveness of controls over their accuracy and completeness. Furthermore, the potential for improper initiation or alteration of information to occur and not be detected may be greater if information is
**AS 2301, The Auditor's Responses to the Risks of Material Misstatement**

| initiated, recorded, processed, or reported only in electronic form and appropriate controls are not operating effectively. |

**Footnote to AS 2301.17**


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**AS 2305, Substantive Analytical Procedures**

<table>
<thead>
<tr>
<th>AS 2305.05</th>
<th>Analytical procedures involve comparisons of recorded amounts, or ratios developed from recorded amounts, to expectations developed by the auditor. The auditor develops such expectations by identifying and using plausible relationships that are reasonably expected to exist based on the auditor's understanding of the client and of the industry in which the client operates. Following are examples of sources of information for developing expectations:</th>
</tr>
</thead>
<tbody>
<tr>
<td>a. Financial information for comparable prior period(s) giving consideration to known changes</td>
<td>Issuer B</td>
</tr>
<tr>
<td>b. Anticipated results—for example, budgets, or forecasts including extrapolations from interim or annual data</td>
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<tr>
<td>c. Relationships among elements of financial information within the period</td>
<td></td>
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<tr>
<td>d. Information regarding the industry in which the client operates—for example, gross margin information</td>
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<tr>
<td>e. Relationships of financial information with relevant nonfinancial information</td>
<td></td>
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</table>
### AS 2305, Substantive Analytical Procedures

<table>
<thead>
<tr>
<th>Analytical Procedures Used as Substantive Tests</th>
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</thead>
<tbody>
<tr>
<td><strong>Availability and Reliability of Data</strong></td>
<td></td>
</tr>
<tr>
<td>AS 2305.16</td>
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</table>

Before using the results obtained from substantive analytical procedures, the auditor should either test the design and operating effectiveness of controls over financial information used in the substantive analytical procedures or perform other procedures to support the completeness and accuracy of the underlying information. The auditor obtains assurance from analytical procedures based upon the consistency of the recorded amounts with expectations developed from data derived from other sources. The reliability of the data used to develop the expectations should be appropriate for the desired level of assurance from the analytical procedure. The auditor should assess the reliability of the data by considering the source of the data and the conditions under which it was gathered, as well as other knowledge the auditor may have about the data. The following factors influence the auditor’s consideration of the reliability of data for purposes of achieving audit objectives:

- Whether the data was obtained from independent sources outside the entity or from sources within the entity
- Whether sources within the entity were independent of those who are responsible for the amount being audited
- Whether the data was developed under a reliable system with adequate controls
- Whether the data was subjected to audit testing in the current or prior year
- Whether the expectations were developed using data from a variety of sources

<table>
<thead>
<tr>
<th>Investigation and Evaluation of Significant Differences</th>
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<tbody>
<tr>
<td>AS 2305.21</td>
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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,
### AS 2305, Substantive Analytical Procedures

| 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 AS 2810.) |

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### AS 2501, Auditing Accounting Estimates

<table>
<thead>
<tr>
<th>EVALUATING REASONABLENESS</th>
</tr>
</thead>
<tbody>
<tr>
<td>AS 2501.12</td>
</tr>
<tr>
<td><strong>Develop an expectation.</strong> 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.</td>
</tr>
</tbody>
</table>

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### AS 2510, Auditing Inventories

<table>
<thead>
<tr>
<th>INVENTORIES</th>
</tr>
</thead>
<tbody>
<tr>
<td>AS 2510.11</td>
</tr>
<tr>
<td>In recent years, some companies have developed inventory controls or methods of determining inventories, including statistical sampling, which are highly effective in determining inventory quantities and which are sufficiently reliable to make unnecessary an annual physical count of each item of inventory. In such circumstances, the independent auditor must satisfy himself that the client's procedures or methods are sufficiently reliable to produce results substantially the same as those which would be obtained by a count of all items each year. The auditor must be present to observe such counts as he deems necessary and must satisfy himself as to the effectiveness of the counting procedures used. If statistical sampling methods are used by the client in the taking of the physical inventory, the auditor must be satisfied that the sampling plan is reasonable and statistically valid, that it has been properly applied, and that the results are reasonable in the circumstances.</td>
</tr>
</tbody>
</table>

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