

Chapter 7—Accepting the Engagement and Planning the Audit

Accepting the Engagement

How does the auditor get data on management's honesty?

1—talk to the prior auditor

2—make inquiries of other third parties such as bankers, vendors, customers, and competitors

3—research various databases such as Lexis-Nexis

4—hire a detective agency

Can the specialist's work affect the type of audit report issued?

Yes. The auditor only refers to the specialist in the audit report if the reference will help users understand the reason for an explanatory paragraph or anything other than an unqualified opinion.

What are some of these audit procedures?

- evaluate the company's procedures for identifying and properly accounting for related party transactions**
- request from management the names of all related parties and inquire whether there were any transactions with these parties**
- review filings with the SEC and other regulatory agencies**
- determine the names of all pension and other trusts established for employees and the names of their officers**
- confirm or discuss significant information with banks, attorneys, guarantors, agents, or others to obtain a better understanding of the transaction**
- refer to financial publications, trade journals, and credit agencies when there is reason to believe that unfamiliar customers, suppliers, or others with which material amounts of business have been done may lack substance**

Precision of an expectation is affected by several factors:

1. methods used to form an expectation

--model-based methods provide the most precise expectations

2. reliability of the data used

--the data used in an analytical procedure may consist of client financial data, operating data or external industry and economic data. The more accurate the data the more reliance can be placed on the procedure. Reliability of financial and operating data will depend on the effectiveness of the client's internal controls.

3. aggregation

--an expectation has greater precision if the analysis is done at a relatively detailed account level

4. predictability of the account

--relationships involving income statement accounts tend to be more predictable than those involving balance sheet accounts since the former represent transactions over a period of time