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The logo is a vertical rectangular graphic with a dark grey background on the left and a white background on the right. The top half features a grid of four squares: light grey, dark grey, black, and a spiral notebook. The bottom half contains the text 'AICPA Executive Education Garverick K2 LarsonAllen Loscalzo Nichols Patrick Realistic CPE Surgent McCoy Werner Rocca' in a bold, black, sans-serif font.

## Advantages of Electronic Course Materials

ISCPA is continuing in our conversion from printed CPE seminar manuals to electronic materials for the majority of its conferences and seminars. A factor in making this decision was cost savings; however, it was not the only consideration. We believe that electronic materials are not only more efficient, but also more effective than paper materials once participants fully understand how to use them. Here are some of the benefits of electronic materials compared with paper materials:

**Easier to Use for Future Reference** - You can store electronic materials on your PC or office server and easily use them for future reference through keyword searches. Trying to find that tax law change or Excel tip covered in a seminar you took a few months ago? With electronic materials, you simply type the keywords in the Windows desktop search tool and find the exact information you need in seconds. Compare that to digging through the stacks of CPE materials located in the corner of your office.

**Easier to Take Notes** - The free Adobe Acrobat Reader X (10) now has enhanced commenting tools, including Sticky Notes and Highlighter tools. Participants can use a laptop, an iPad or similar device, or even a smartphone to insert comments, highlight passages of interest, or take notes.

**Easier to Access** - When a PDF document is annotated using a PDF tool, the information is much easier to access than when similar annotations are made in paper materials. You simply open the file and can either scroll through a list of annotations, search the annotations, or print a list of the annotations.

**Easier to Store** - Instead of taking up shelf or floor space like paper manuals do, electronic manuals can be stored on a local drive or a file server. This makes them easier to find and allows participants to keep materials for longer periods.

**More Up-to-Date Materials** - Author submission deadlines can be “softer,” since there is no need to print and ship. Further, when last-minute updating is needed (for example, due to a last-minute tax law change), the authors can easily provide participants with updated materials, in some cases even as late as the day of the course.

**Manuals Can Still Be Printed** - Anyone who prefers paper (and there will still be many who do) can print the manuals prior to the course and bring the printed materials with them.

**Helps Keep Society Costs Down – & We Pass on the Savings to YOU** - Eliminating printed materials clearly saves money and wear and tear on staff and equipment. Although costs have continued to increase in the CPE seminar arena, ISCPA didn't raise the cost of our seminars this year thanks in part to this cost saving measure.

**Our Sustainability Goal** - As a bonus, such action is also environmentally friendly and helps us on our path toward sustainability.

## Define Your Purpose

If they wish to achieve some degree of efficiency in their work, analysts must first define their purpose. Traditionally, there are three reasons for conducting a financial statement analysis:

- Solvency assurance,
- Wealth enhancement, and
- Performance assessment.

When our purpose is solvency assurance, we want to ensure that cash flows are sufficient to pay obligations. The focus of this analysis will be on measures of liquidity and solvency.

When wealth enhancement is our goal, we primarily consider metrics involving earnings and asset or equity utilization. We are looking for consistent, long-term profitability growth.

Finally, performance assessment directs the analysis towards cash flows, earnings and operational excellence. As a result, the analyst must reflect measures involving each of these areas.

Know where you are going before you begin the journey!

## FSA: A Financial Statement Approach

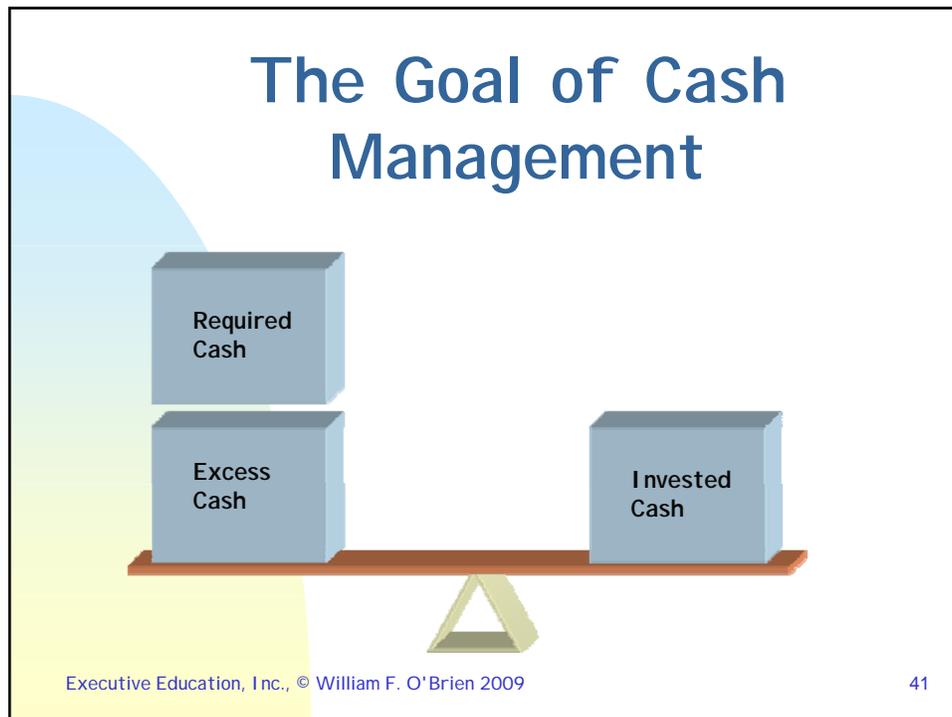
Let's begin our discussion with some general guidelines for FSA success. Initially, we discuss the 3 P's of FSA:

- Planning,
- Processing, and
- Presenting.

Planning includes defining the purpose of the work and gathering all of the relevant data. Processing implies the use of measures appropriate for the intended purpose in some consistent manner or framework. See the suggested list of common financial metrics in the **Resources** section of the seminar manual.

While the first two P's command much of the analyst's attention, presenting often draws limited consideration. This is a critical oversight. I often recall some advice given to me many years ago regarding presentations. The speaker should simply:

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## Power-up the Process Using Some AMPS

- **A**wareness of cash needs
- **M**aximize operational cash flows
- **P**lan for external sources of cash
- **S**hort-term investment success

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## Clarity Project Questions and Answers

**Question** - Once all of the ASB's clarified standards have been finalized, how will they be issued?

**Answer** - The ASB will issue the majority of the clarified standards in a single SAS codified in AU section format, with each section assigned a section number and title, just as the ASB did in 1972 when SAS No. 1, *Codification of Auditing Standards and Procedures*, was issued. To address certain practice issues, the following clarified SASs (discussed earlier in this chapter) have already been issued and assigned a number:

- SAS No. 117, *Compliance Audits* (Effective for compliance audits for fiscal periods ending on or after June 15, 2010, with early application permitted.)
- SAS No. 118, *Other Information in Documents Containing Audited Financial Statements*
- SAS No. 119, *Supplementary Information in Relation to the Financial Statements as a Whole*
- SAS No. 120, *Required Supplementary Information*

(SAS Nos. 118–120 are effective for audits of financial statements for periods beginning on or after December 15, 2010, with early application permitted.)

**Question** - Will the numbering of the SASs start over again with the single SAS that contains the clarified standards being SAS No. 1?

**Answer** - No. The number of the single SAS will be the next consecutive number that is available. For purposes of the remainder of these questions, presume that the single SAS that contains the clarified standards will be issued as "SAS No. 12X."

**Question** - What will happen to the SASs currently in effect?

**Answer** - When SAS No. 12X becomes effective, the SASs issued prior to SAS No. 117 will be superseded.

**Question** - How will the numbering and titles of the current AU sections change?

**Answer** - The ASB is conducting the Clarity Project to clarify all existing AU sections. In some cases, individual AU sections are being clarified "one for one" into individual clarified standards. In other cases, certain AU sections are being grouped together and clarified into one or more clarified standards. As a result, topics currently associated with certain AU section numbers might be retitled and assigned different AU section numbers. A schedule (available at [www.aicpa.org](http://www.aicpa.org)) has been prepared that maps the existing AU sections to the proposed SASs that would supersede them.

**Question** - Once SAS No. 12X is effective, will the ASB continue to issue SASs?

**Answer** - Yes. Just as it has done up until now, the ASB will continue to issue SASs that create, amend, or supersede AU sections. In this case, the SASs issued subsequent to SAS No. 12X will affect the AU sections contained in SAS No. 12X.

## Appendix A

### **Operating Ratios**

- A/R Turnover  
= Sales / Avg. A/R
- Days Sales Outstanding  
= A/R / Avg. daily sales
- Inventory Turnover  
Cost of Goods Sold / Avg. inventory
- Days in Inventory  
= 365 / Inventory turnover
- A/P Turnover  
= Purchases (or Total expenses) / Avg. A/P
- Days in Payables  
= 365 / A/P turnover
- Days in Payables (alternative)  
= A/P / Avg. daily input to A/P
- Fixed Asset Turnover  
= Sales / Avg. fixed assets
- Repair & Maintenance Expense to Gross Fixed Assets  
= Repair & maintenance expense / Gross fixed assets

program, the auditor should assess control risk at the maximum. Maximum control risk may result in higher remaining risk of material noncompliance, and the desired level of assurance from the compliance test also increases to moderate or high to support an unqualified opinion on the auditee's compliance.<sup>12</sup>

**11.80** As noted in the prior paragraph, the risk of material noncompliance is affected by the inherent risk for the particular type of compliance requirement. There are many factors that can affect inherent risk, for example, the regulatory environment, the significance of the particular requirement to the overall program, the complexity of relevant regulations, changes in regulations, or the experience the auditee has with the federal program. In assessing the remaining risk of material noncompliance, the engagement team may also consider the results of procedures performed in connection with the audit of the financial statements.

**11.81** Auditors, in assessing inherent risk, typically assess risk factors associated with the types of compliance requirements being tested. Further, there are general risk factors which may suggest the need to obtain a higher level of assurance from an audit sample. Examples of such risk factors are discussed in paragraph 11.65. Audit risk considerations including inherent risk are also discussed in chapter 6 of this guide.

#### *Tolerable Exception Rate*

**11.82** The tolerable exception rate for compliance tests is the maximum rate of compliance exceptions that auditors are willing to accept. The tolerable exception rate for all types of compliance requirements is related to program materiality. Materiality is considered in relation to each major program. The quantitative thresholds used to determine if an exception is an "audit finding" related to a major program is lower than the materiality used for planning the Circular A-133 compliance audit and expressing an opinion on the auditee's compliance (materiality is also discussed in chapter 6 and chapter 8, "Determination of Major Programs," of this guide).

**11.83** The determination of major program materiality is a matter of professional judgment. The tolerable exception rate for a compliance sample testing nonmonetary compliance attributes (for example, Reporting type of compliance requirement) as well as monetary compliance attributes (for example, Allowable Costs/Cost Principles type of compliance requirement) is normally equal to or lower than the level of materiality for expressing an opinion on the auditee's compliance with requirements having a direct and material effect on each major program. For example, if program materiality is determined to be 5 percent of program expenditures, then the tolerable exception rate for a compliance sample testing monetary attributes would be 5 percent or less. Similarly, if a 5 percent exception rate for a nonmonetary compliance attribute is considered material, then the tolerable exception rate for compliance sample testing that nonmonetary attribute would be 5 percent or less. The compliance testing sample size table is based on a 5 percent tolerable exception rate for both nonmonetary and monetary attributes. If program materiality is set lower than 5 percent, then the tolerable exception rate would be lowered, and the minimum sample sizes may need to be adjusted upward. The AICPA Audit Guide *Audit*

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<sup>12</sup> However, if during the testing of the compliance sample, the auditor finds sufficient evidence of noncompliance to support an opinion other than unqualified, the auditor is not required to test remaining or additional items.

## 270 Government Auditing Standards and Circular A-133 Audits

*Sampling* provides tables and guidance for auditors desiring to design audit samples for different tolerable exception rates.

### *Expected Population Exception Rate*

**11.84** The compliance testing sample size table is based on an expectation of no exceptions. If testing discovers no exceptions, then the desired level of assurance is obtained that compliance is effective. When more exceptions are encountered than were planned for, the auditor has not met the planned audit objective. Auditors may develop their own sample sizes with planned exceptions. Appendix A of the AICPA Audit Guide *Audit Sampling* provides tables and guidance for auditors desiring to design audit samples when exceptions are expected.

**11.85** All exceptions (whether planned or not) should be investigated to determine the potential effect on the program. Although not all exceptions will lead to a finding, the auditor should evaluate compliance exceptions (whether planned or not) for their nature and cause to determine the potential effect on the program.

### *Testing Small Populations*

**11.86** Some significant controls or instances, or both, of compliance do not occur frequently (for example, submitting a required report). The following table provides suggested minimum sample sizes in testing small populations subject to controls and compliance requirements.<sup>13</sup> *Small populations*, for purposes of this chapter, are defined as populations of fewer than 250 items.

*Small Population Sample Size Table*

<i>Frequency and Population Size</i>	<i>Sample Size</i>
Quarterly (4)	2
Monthly (12)	2–4
Semimonthly (24)	3–8
Weekly (52)	5–9

**11.87** For populations between 52 and 250 items, a rule of thumb some auditors follow is to test a sample size of approximately 10 percent of the population, but the size is subject to professional judgment, which would include specific engagement risk assessment considerations.

**11.88** For more significant controls discussed in paragraphs 11.61–.64, or for more significant types of compliance requirements, the auditor may determine the appropriate sample size is on the larger end of the ranges displayed in the small population sample size table.

**11.89** The auditor may consider the size of the population by reference to the defined sampling unit. For example, in some cases, the auditor may need to consider the populations from several locations or components; if there were weekly controls over the occurrence of expenses at each of 40 departments, the population of weekly expense test controls would be 2,080 (52 × 40), and this would not be a small population.

<sup>13</sup> The table is adapted from table 3-5, "Small Population Sample Size Table," in the AICPA Audit Guide *Audit Sampling*.

## AAG-SLA 11.84

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**Illustrative Auditor's Reports for Program-Specific Audits**  
**Under OMB Circular A-133**  
Revised for SAS No. 115

[Signature]

[Date]

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In accordance with *Government Auditing Standards*, we have also issued our report dated [date of report] on our consideration of Example Entity's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide opinions on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The second sentence of this paragraph should be modified if the auditor is providing an opinion on internal control over financial reporting or on compliance.

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## Chapter 5

### Solution to Exercise 5-1

