NINJA CPA Review®

NINJA Notes

Auditing & Attestation

January - July 2023

The 2023 CPA Exam

Source: AICPA

Content Area		Allocation
Area I	Ethics, Professional Responsibilities, and General Principles	15-25%
Area II	Assessing Risk and Developing a Planned Response	25-35%
Area III	Performing Further Procedures and Obtaining Evidence	30-40%
Area IV	Forming Conclusions and Reporting	10-20%

Skill Levels	
Evaluation	The examination or assessment of problems, and use of judgment to draw conclusions.
Analysis	The examination and study of the interrelationships of separate areas in order to identify causes and find evidence to support inferences.
Application	The use or demonstration of knowledge, concepts or techniques.
Remembering and Understanding	The perception and comprehension of the significance of an area utilizing knowledge gained.

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The N.I.N.J.A. Framework

How to use NINJA Notes

Reading

You've invested in NINJA Monthly, now let the NINJA Notes go to battle for you. You should read them as many times as possible.

Carry it with you wherever you go.

Simply load the PDF onto your mobile device, and **if you have 5 minutes of downtime, you have 5 minutes of study time**.

It is recommended that you read the NINJA Notes at least **five times** leading up to your final two weeks of exam prep.

If you have 6 weeks to study, then you need to complete this in 4 weeks. 5 weeks to study, then complete it in 3. 4 weeks = 2 weeks. You get the picture. The point is: plan, plan, plan and budget, budget, budget, budget because exam day is looming.

Learning Plans	
6-Week Plan	• Approx. 82 pages x 5 reads • 4 weeks • 7 days per week = Approx. 15 pages per day
5-Week Plan	• Approx. 82 pages x 5 reads • 3 weeks • 7 days per week = Approx. 20 pages per day
4-Week Plan	• Approx. 82 pages x 5 reads • 2 weeks • 7 days per week = Approx. 29 pages per day
3-Week Plan	• Approx. 82 pages x 5 reads • 1 week • 7 days per week = Approx. 59 pages per day

Rewriting The NINJA Notes

This step is optional, but it won over a lot of skeptics with its results. This is not mainstream advice. This is the NINJA way. The mainstream way of studying for the CPA Exam is old-fashioned and outdated.

Forget the old way. **You are a NINJA now**.

Now is the time to either:

1. Rewrite your own CPA Exam notes or
2. Rewrite the NINJA Notes.

Plan on investing a week doing this, and you should expect to get through at least 20 pages a day to stay on track.

VI. Audit Sampling

- Audit Sampling is taking part of a population, subjecting it to audit procedures, projecting results to a population
    - Example – You have 100 gumballs and you test the quality of 10 of them and make an inference about the entire bag of gumballs based on the 10 that you sampled
- Statistical Sampling
    - Based on formulas
    - Helps find an appropriate audit sample
    - Helps evaluate evidence obtained
    - Evaluate results and quantifies Sampling Risk
- Non-Statistical Sampling
    - Based on a human decision
    - Equally acceptable as Statistical Sampling
- Substantive Tests
    - Variables Sampling
    - Probability Proportionate to Size Sampling
- Control Tests
    - Attribute Sampling

Sampling Risk

- Sampling Risk is the risk that your sample isn't representative of population
    - Can happen even if audit is done properly
    - Example – You sample 10 gumballs out of 100 and conclude that the bag of gumballs is acceptable for sale to your customers, when in fact the other 90 are inedible
- Risk of Assessing Control Risk Too High
    - A risk of Control Testing where the sample overstates Control Risk
    - Auditor works to make Control Risk lower
        - Does more substantive testing
    - Leads to an under-reliance on Internal Control, over-testing, and overall *Audit Inefficiency*
        - Audit ends up being effective (correct result), but the auditor does more work than necessary
- Risk of Assessing Control Risk Too Low
    - A risk of Control Testing where the sample *understates* Control Risk
        - This error leads to over-reliance on Internal Control, under-testing, and overall *Audit Ineffectiveness*
    - Inverse relationship to Sample Size
        - Higher accepted risk of assessing Control Risk too low = Smaller Sample

        - Lower accepted risk of assessing Control Risk too low = Larger Sample
    - Leads to higher Detection Risk
        - Recap: Detection Risk is the risk that the auditor will fail to detect a material misstatement
        - Auditor does fewer Substantive Tests
    - Does NOT necessarily mean that the Financial Statements are materially misstated –
        - However, it does mean that if there is one, the auditor is less likely to find it
- Incorrect Acceptance
    - A risk of Substantive Testing
    - Auditor accepts a balance as fairly stated, when in fact it is not fairly stated
        - Hurts audit effectiveness
        - Wrong conclusion reached
        - Efficient, but not effective
- Incorrect Rejection
    - A risk of Substantive Testing
    - Auditor rejects balance as fairly stated when in fact it *is* fairly stated
        - Hurts audit efficiency
        - Wrong recommendations given
        - Effective, but not efficient
- Non-Sampling Risk

        - Risk of human (Auditor) missing an error
            - Synonyms: Exception, Error, & Deviation
- Sampling vs. Non-Sampling Risk
    - Sampling Risk deals with the chance that your audit *sample* is flawed
    - Non-Sampling risk deals with the chance that your *human decisions/conclusions* are flawed

Attribute Sampling

- Looking at Control Procedures
    - Were invoices approved when paid?
- Errors are stated in terms of %, not dollar amount
    - 5 invoices out of 100 were not properly paid
        - Error Rate is 5%
        - If you see “error rate” on the CPA Exam, they are referring to Attribute Sampling
- Control Procedures are either operating properly or they are not operating properly – based on Error Rate and the tolerance you have for errors
- Tolerable Rate
    - Error rate in population that you are willing to accept/tolerate
    - Inverse relationship to Sample Size
        - Higher Tolerable Rate = Smaller Sample
        - Lower Tolerable Rate = Larger Sample

        - If you're willing to accept a higher probability that errors exist, there is less pressure on the sample
    - Expected Population Error Rate
        - What Error Rate are you expecting?
            - Judgment call for Auditor
            - Based on Auditor's experience
        - Direct relationship to Sample Size
            - More errors = Larger Sample
            - Less errors = Smaller Sample
- Attribute in the sample gives information about the entire audit population
- Used to estimate Internal Control error rate
- Expected Population Deviation (error) Rate
    - Used to determine initial level of Control Risk
- Allowable Risk of Over-reliance
    - Risk of Assessing Control Risk Too Low
    - Gives you the Sampling Risk
- Attribute sampling is only useful when there is documented evidence (an audit trail) to test
- Use when the *existence of an error* needs to be verified or debunked

Classic Variables Sampling

- Testing for a dollar amount
- Value in sample gives information about value in entire population
- Mean Per Unit
    - Sample Average x Number in Population
- Stratification
    - Similar transactions are grouped together (>$1M and <$1M) and then subjected to audit procedures
    - Decreases effect of variance in population and reduces sample size

Probability Proportionate To Size (PPS)

- A form of Variable Sampling
- Does NOT use Standard Deviation
- Auditor focuses on a dollar amount
- Larger or more valuable items get picked more often as part of the sample
- Projected Misstatement
    - Misstatement found in sample – Auditor must project it to remainder of population

Classic Variables Sampling vs PPS

- Classic Variables Sampling
    - Easy to expand sample size
    - Selecting zero and negative balances easy
- PPS
    - Easier to use
    - Results in a stratified (homogenous) sample
    - Results in a smaller sample size to audit
    - Easy to design

Factors That Affect Sample Size

- Tolerable Rate for Error
    - *Inverse* relationship with Sample Size
- Risk of assessing Control Risk too low
    - *Inverse* relationship with Sample Size
- Expected Population Error Rate
    - *Direct* relationship with Sample Size
- Population size does NOT affect the sample size
    - As population grows larger, sample size doesn't grow with it

Formula For Audit Sampling

- SER + ASR < TER
- Sample Error Rate (SER)
    - 5 out of 100 invoices were not approved correctly
    - Sample Error Rate = 5%
- Allowance for Sampling Risk (ASR)
    - The amount that you add to the Sample Error Rate (SER) to get some cushion for your sample
    - Allow for as high as you think the population error rate could go based on experience
    - ASR is set at 2%, based on judgment
    - Population error rate could reach 7% (5+2)
- Tolerable Error Rate (TER)
    - Error rate auditor is willing to accept
    - If population error rate < TER
        - Accept the Control as effective
    - If population error rate > TER
        - Do more testing to get SER lower or
        - Conclude control isn't effective

Sampling Plans

- Determine Test Objective
    - Have sales shipments been billed?
- Define Population and Deviation
    - Take a sample of shipping documents
    - Trace forward to see if they were billed
- Determine Sample Size based on
    - Tolerable Error Rate
    - Risk of assessing Control Risk Too Low
    - Expected Population Error Rate
- Select Sampling Technique
    - Random
    - Sequential
    - Systematic
- Perform Sampling Plan
- Evaluate Results
- Document Results

Systematic Sampling

- Every certain # of a population is selected
- Population *needs* to be randomly ordered
- Population doesn't require pre-numbering

Sequential Sampling

- Also called “Stop or Go” Sampling
- Each audit step determines the next step

Discovery Sampling

- Audit is testing an area that is so crucial that zero population errors can be tolerated
    - Any phony employees on payroll?

Block Sampling

- Easy to implement, but **worst** method of sampling
    - Example: Auditor picks all transactions from June and then projects the results to the rest of the year

Data Analytics

- Identifies Trends in Large Amounts of Data
    - Used for Predictions & Decision-Making
    - Used to Identify Fraud
    - Used to Identify patterns (e.g., healthcare transactions for patients)
    - Used in Sampling
- Big Data
    - Volume
        - Quantity of Data

    - Veracity
        - Quality or Accuracy of Data
    - Velocity
        - Speed at which data is obtained
    - Variety
        - Type of data being dealt with

- Types of Analytics
    - Descriptive Analytics
    - Diagnostic Analytics
    - Predictive Analytics
    - Prescriptive Analytics

- Data Visualization
    - Line Chart
    - Bar Chart
    - Pie Chart
    - Histograms
    - Scatterplot
    - Tables