

Auditing Standards and Economic Environment Updates

Stay current with the latest developments from the Auditing Standards Board and understand how today's economic environment is shaping audit practice. This section covers pending ASB projects, the implications of economic volatility for auditors, and related accounting issues — including a focused look at going concern considerations heading into 2026. Ideal for practitioners who want a solid foundation in the current audit landscape before diving into more specific risk and fraud topics.

CREDIT HOURS 2 | FIELD OF STUDY AUDITING | EXAM QUESTIONS 10

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LEARNING ASSIGNMENTS AND OBJECTIVES

Assignment

- Study the full course materials included here.
- Complete the review questions after each chapter.
- Answer 10 final exam questions.
- Final exam is scored immediately, 70% or better passes.
- Certificate of completion is available in your account.
- Failed exams can be retaken free of charge.

Course Objectives

- Review the method used to estimate credit losses under ASU 2016-13.
- Recognize the two elections ASU 2025-05 requires if an entity wishes to use subsequent collections to measure the year end allowance account for accounts receivable.
- Identify how to account for the PTE tax on company financial statements.
- Identify a scenario in which it would be impracticable for an auditor to attend a physical inventory.
- Recognize an advantage of remote auditing.

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Section 1

Chapter Objective

After completing this assignment, you should be able to:

- Review the method used to estimate credit losses under ASU 2016-13.
- Recognize the two elections ASU 2025-05 requires if an entity wishes to use subsequent collections to measure the year end allowance account for accounts receivable.
- Identify how to account for the PTE tax on company financial statements.
- Identify a scenario in which it would be impracticable for an auditor to attend a physical inventory.
- Recognize an advantage of remote auditing.

I. AUDITING STANDARDS BOARD (ASB)- PROJECTS PENDING

A. FRAUD EXPOSURE DRAFT

On July 3, 2025, the Auditing Standards Board (ASB) issued an exposure draft entitled *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*.

The exposure draft is the product of more than three years of outreach and research by an ASB task force, which also considered alignment of the proposed standard, where appropriate, with a similar project by the International Auditing and Assurance Standards Board (IAASB). The ASB also continues to monitor a similar project at the Public Company Accounting Oversight Board (PCAOB).

This exposure draft doesn't alter the overall objectives of the auditor when fraud or suspected fraud is identified. Instead, it strengthens and clarifies the auditor's specific role in these circumstances.

1. The exposure draft would update the auditors' responsibilities related to fraud, and contains a number of changes, including:
 - The establishment of required procedures for when an auditor has identified fraud or suspected fraud, and
 - A reminder for auditors to maintain professional skepticism throughout the audit.
2. If issued as final, the proposed SAS would supersede SAS No. 122, Statements on Auditing Standards: Clarification and Recodification, as amended, Section 240,

Consideration of Fraud in a Financial Statement Audit (AU-C Section 240), and amend several other standards.

Proposed changes in the exposure draft include:

- New requirements to clarify the auditor’s response when fraud or suspected fraud is identified in an audit of financial statements, which are among the most significant changes in the proposed SAS.
- Additional guidance to explain the relationship of fraud with corruption, bribery, and money laundering, as well as fraud committed against an entity by third parties.
- A new requirement that emphasizes the importance of remaining alert throughout the audit for information that is indicative of fraud or suspected fraud.
- A new requirement for the engagement partner, when addressing engagement resources, to determine that members of the engagement team collectively have the appropriate competence and capabilities, including sufficient time and appropriate skills or knowledge to perform the audit.
- A broadening of the requirement for an auditor to perform a *retrospective review* of management judgments and assumptions related to accounting estimates reflected in the financial statements of the prior year, and not just those of significant accounting estimates.
- A new requirement for the auditor to treat the risk of management override of controls as a risk of material misstatement due to fraud at the financial statement level and to determine whether such risk affects the assessment of risks at the assertion level.
- An enhanced requirement for an auditor to take into account related fraud risk factors when determining which types of revenue, revenue transactions, or relevant assertions give rise to risks of material misstatement due to fraud.
- Clarification that even when an identified misstatement due to fraud is not “quantitatively material,” it may nevertheless be “qualitatively material” depending on who instigated or perpetrated the fraud (such as management) and why the fraud was perpetrated.
- Requirements regarding communications with management and the governing body throughout the audit engagement.

If issued as a final statement, the proposed SAS would be effective for audits of financial statements for periods ending on or after December 15, 2028, with early implementation permitted.

B. EXTERNAL CONFIRMATIONS- EXPOSURE DRAFT

On February 27, 2025, the ASB issued an exposure draft of proposed SAS External Confirmations.

The exposure draft amends the following:

- AU-C 500, Audit Evidence

- AU-C 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*
- AU-C 505, External Confirmations

The exposure draft is going through revisions by the ASB with a final statement expected to be issued sometime in 2026. In the meantime, following are the key changes to confirmations that are being proposed:

1. Amendment to AU-C 330

New Requirement to Confirm Cash and Cash Equivalents

The proposed amendment to AU-C section 330 would add a new paragraph that requires the auditor to use external confirmation procedures (the definition of which includes directly accessing information held by a confirming party) for cash and cash equivalents held by third parties (cash) to respond to the assessed risks of material misstatement for certain relevant assertions of significant classes of transactions, account balances, or disclosures.

Documentation

The proposed amendment would revise the requirement to document the basis for any determination not to use external confirmation procedures for both accounts receivable and cash. The proposed amendment expands the documentation for accounts receivable by removing “when the account balance is material” from the requirement and instead ties the documentation requirement directly to the circumstances in which exceptions to the use of external confirmation procedures are present.

Other Changes

A proposed amendment would clarify that external confirmation procedures are not required for all classes of transactions, account balances, or disclosures, but only those that are determined to be significant (those that have risks of material misstatement). A proposed amendment includes additional examples of situations in which external confirmation procedures may provide audit evidence in responding to identified risks of material misstatement at the assertion level.

2. Amendment to AU-C Section 505

Definitions

The proposed amendments include the addition of definitions for the following terms to provide clarification:

- Confirmation request
- Confirming party
- External confirmation procedures

- Intermediary

Selecting a Confirming Party

The proposed revisions provide clarity that there may be instances in which government regulatory bodies may be knowledgeable about the information to be confirmed and are an appropriate confirming party. For example, the ASB is aware of situations in which state auditors use government regulatory bodies as a confirming party.

The proposed new paragraph .A9 clarifies that the auditor may consider revising the assessment of relevant risks of material misstatement and modifying the nature, timing, and extent of other audit procedures when the auditor is unable to identify a confirming party who would provide a relevant and reliable external confirmation response. The ASB believes that this additional application material is a helpful reminder to auditors.

Other Changes

The proposed amendments include examples of when the auditor's understanding of arrangements and transactions may assist the auditor in determining the information to be confirmed or requested, including individual items for which audit evidence is obtained. The proposed revisions explain that information that calls into question the potential confirming party's motivation, ability, or willingness to respond, or objectivity and freedom from bias with respect to the audited entity, may be an indication of incentives or pressures for the external confirmation responses to be inaccurate or otherwise misleading. The proposed revisions provide factors that may indicate doubts about the reliability of an external confirmation response.

3. Amendment to AU-C Section 500

The proposed amendment to AU-C section 500 adds application material to paragraph .A15 that the ASB believes will enhance the quality of audits of financial statements of nonissuers. Paragraph .A15 explains that confirmation requests need not be restricted to classes of transactions, account balances, and disclosures. The additional application material provides examples of when such confirmation requests may be appropriate. Although the PCAOB included a requirement to consider confirmations in these circumstances,⁴ the ASB included this as application material to align with the principles-based approach in determining the appropriate responses to the auditor's risk assessment. Amendments to paragraph .A55 are conforming amendments to align with the changes to the definitions in AU-C section 505.

The amendments would be effective for audits of financial statements for periods ending no earlier than December 15, 2027. Early implementation would be permitted.

II. IMPLICATIONS OF THE CURRENT ECONOMIC ENVIRONMENT FOR AUDITORS

A. GENERAL

In planning an audit, an auditor is required to comply with AU-C 300, *Planning an Audit*, which requires that the auditor establish an overall audit strategy and develop an audit plan.

As part of planning, an auditor must follow AU-C 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, which requires an auditor to perform risk assessment procedures to gather information and gain an understanding of the entity and its environment, including its internal control.

Each industry is subject to specific business risks arising from the nature of the business. Business risks arise from certain conditions, events, and circumstances.

Factors that an auditor may consider in understanding the entity and its environment include:

1. Industry, regulatory, and other external factors, such as:
 - The market and competition
 - Cyclical or seasonal activity
 - Product technology
 - Supply availability and cost
 - Accounting principles and industry-specific practices
 - Legislation and regulation affecting the entity's operations
 - General economic level
 - Interest rates, financial, inflation, and currency revaluation issues
 - Relevant accounting pronouncements
 - The legal and political environment
 - General economic conditions
 - Competitive and technical conditions, and
 - Social conditions.
2. Nature of the entity, including:
 - Ownership
 - Entity's operations
 - *Governance*
 - Financing sources and structure, and
 - Related party transactions.

3. Objectives, strategies, and related business risks.
4. Measurement and review of the entity's financial performance.
5. Internal control, including the selection and application of accounting principles.

Any of the previous factors can affect several aspects of an audit, including going concern, fraud, internal control, use of accounting estimates, and analytical procedures, to name a few.

Although most risks eventually affect the financial statements, not all such risks result in material misstatements to the financial statements. Consequently, the auditor is not responsible for identifying or assessing all business risks.

B. STATUS OF THE U.S. ECONOMY IN 2026- IMPACT ON AUDITORS

The COVID-19 pandemic has been over for more than four years and certainly has left in its wake seismic effects on the U.S. economy across most sectors and industries.

There was legislation passed during and after COVID-19 that still directly affects 2026 and 2025 financial statements and related disclosures. That legislation is summarized in the following chart:

Legislations	Date of passage
Coronavirus Aid, Relief, and Economic Security Act (CARES Act) (Section 2301)	March 2020
Consolidated Appropriations Act of 2021 (CAA) (Section 206 of the Taxpayer Certainty and Disaster Tax Relief Act)	December 2020
American Recovery Plan (ARP)	March 2021
Infrastructure Investment and Jobs Act	November 2021
Inflation Reduction Act of 2022	August 2022

Auditors must consider the impact of the post-COVID economy on the financial health of their clients, and how to reflect its effects, if any, in 2026 and 2025 financial statements and disclosures.

In addition, as of January 2026, the U.S. economy has seen a significant reduction in inflation from where it was two years ago. January 2026 inflation is 2.04%. Although the U.S. Government has announced that it has inflation under control, there are still pockets of inflation within certain industries.

Some of the more important issues that may affect 2026 and 2025 financial statements include the following:

- Impact of tariffs and inflation on company operations, and
- Ongoing exposure to high interest rates.