



# Risk-Based Auditing with ProSystem *fx*<sup>®</sup> Knowledge Coach



## CCH's Knowledge-Based Audit™ (KBA) Methodology — What it is and How it Works

Over the last few years CCH, a Wolters Kluwer business, has been delivering publications, research tools, and software applications that incorporate a powerful, robust and flexible audit methodology referred to as KBA, or the Knowledge-Based Audit. This methodology, developed to meet the AICPA's latest risk-based audit standards, helps auditors plan and execute audits in a way that minimizes compliance risk and maximizes effectiveness.

This paper provides background on the KBA methodology, how it's structured, how it's used, and how it has been applied using ProSystem fx® Knowledge Coach.

## Why KBA was Developed

CCH developed the Knowledge-Based Audit™ (KBA) methodology in response to the AICPA's issuance of Statements on Audit Standards, No. 104 – No. 111, (the Risk-Assessment Suite). The purpose of the methodology is to aid auditors in performing accurate, efficient and effective financial statement audits of nonpublic commercial entities that are not only compliant with auditing standards generally accepted in the United States of America (GAAS), but specifically with the new risk-based audit requirements. The KBA Methodology was developed by auditors with years of professional engagement experience and has been evaluated through AICPA Peer Review.

The KBA methodology empowers the entire audit solution set that CCH offers. It is available on our Accounting Research Manager® (ARM) research platform, embedded in our industry-specific ProSystem fx® Knowledge Tools audit aids, and utilized by our Knowledge Coach audit workflow application. Knowledge Coach is fully integrated with ProSystem fx® Engagement, and helps streamline the entire audit from planning through completion.

## How KBA is Structured

### Risk-Based Methodology Depends on the Right Knowledge

The Knowledge-Based Audit is a risk-based audit methodology that emphasizes using knowledge of the entity to make the risk assessments in connection with a financial statement audit. Because an auditor does not test 100% of the transactions of an entity, all audits are risk based to some extent. The more accurately an auditor assesses an entity's risks of material misstatement, the more assurance the auditor has that the procedures performed in response to the risk assessments will detect material misstatements. Therefore, the primary drivers of the KBA approach are:

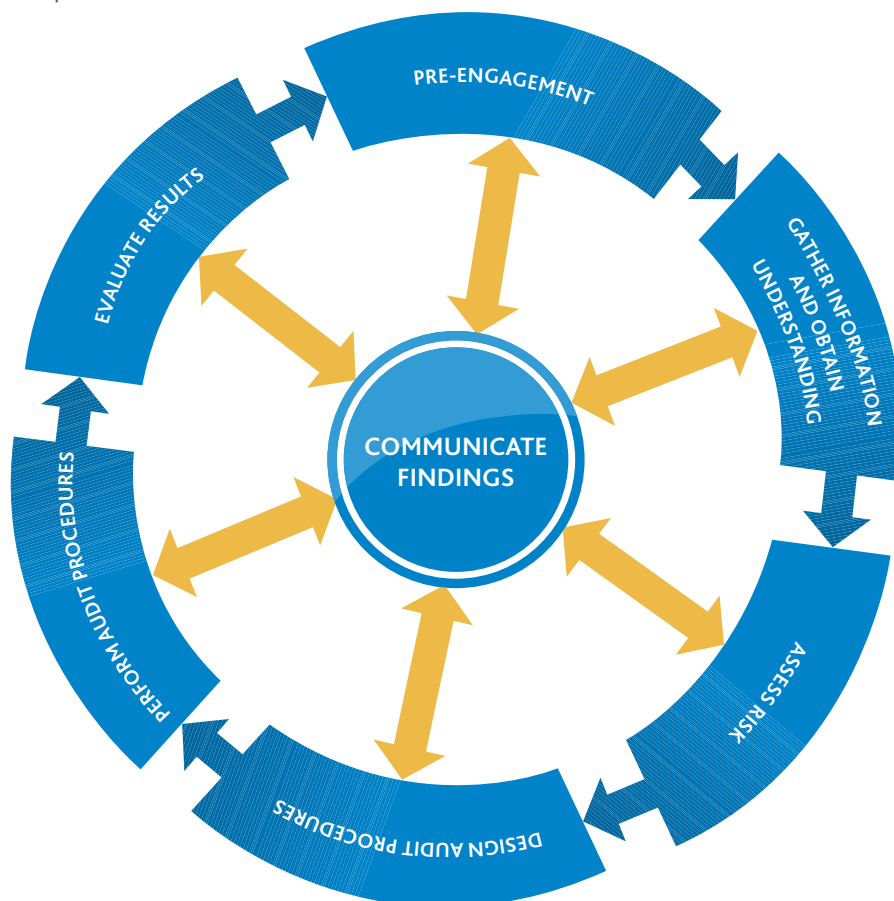
- Obtaining an understanding of the entity and its environment, including its internal control, sufficient to accurately assess the risks of material misstatement.
- Designing and performing audit procedures that are responsive to the risks of material misstatement.

## Information Flows Through Each Phase, But Not Necessarily in a Linear Process

For an audit to be effective, information — or knowledge — must flow through each phase of the audit process. There are eight processes in the KBA methodology:

1. Pre-Engagement Procedures
2. Risk Assessment Procedures: Obtaining an Understanding of the Entity and Its Environment
3. Risk Assessment Procedures: Evaluating the Design of Internal Controls
4. Assessing the Risks of Material Misstatement
5. Designing Audit Procedures in Response to Assessed Risks
6. Performing Audit Procedures: Tests of the Operating Effectiveness of Internal Controls
7. Performing Audit Procedures: Substantive Tests
8. Evaluating, Concluding, and Reporting Procedures

The knowledge obtained in each process affects the decisions made in the next. Although the auditor will likely perform most steps in the methodology sequentially, an audit is not necessarily a linear process. The auditor may need to reconsider decisions made in an earlier process based on evidence obtained in a later stage of the audit. Knowledge Coach facilitates the capture of this information by allowing the auditor to easily access the original source of the information and make the appropriate changes, which the application then flows throughout the rest of the engagement workpapers as necessary.



## How the KBA Methodology Works with ProSystem fx® Knowledge Coach

### Facilitating the Flow of Information

The KBA audit approach, as applied through Knowledge Coach, is designed to aid the flow of information seamlessly throughout the audit as follows:

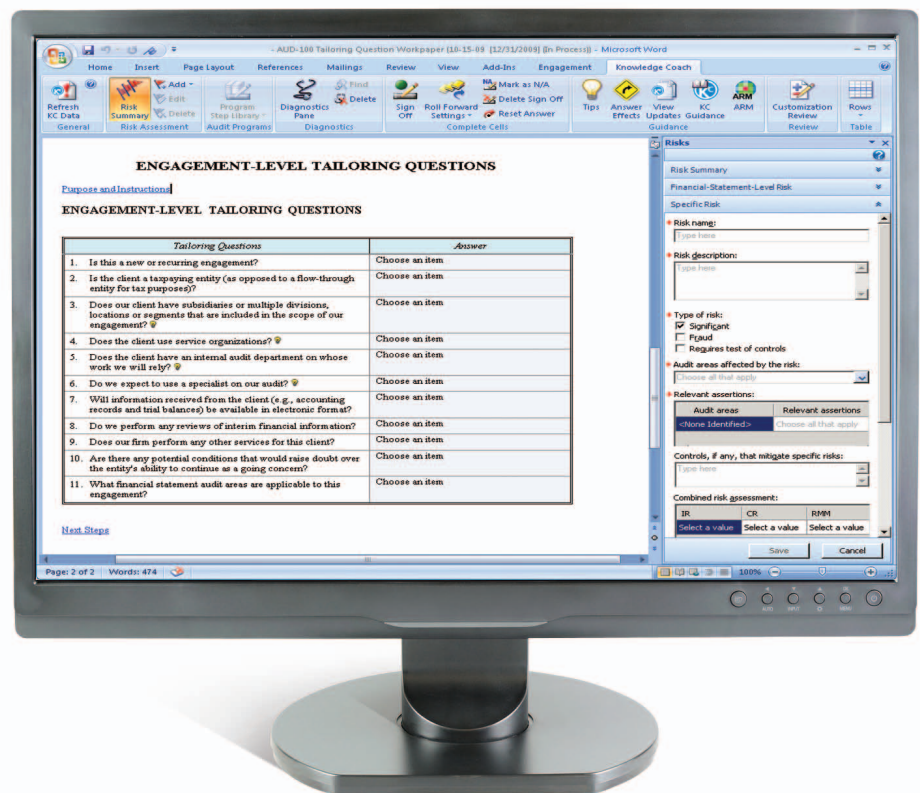
1. Knowledge gained from pre-engagement procedures, the determination of materiality, and preliminary analytical procedures is used to customize the audit plan for risk assessment procedures.
2. Knowledge gained from risk assessment and other procedures is used to identify and assess the risks of material misstatement.
3. Knowledge gained from risk assessment procedures and the risks of material misstatement is used to customize the audit plan for further audit procedures.
4. Evidence gained from further audit procedures is evaluated to determine whether audit risk has been reduced to an acceptably low level, and the appropriate auditor's report is issued.

### A Tool Set that Enables Each Step

Aligning directly with the methodology, the KBA audit tool set within Knowledge Coach includes the **Overall Audit Program** that assists the auditor in the completion of each phase of the audit, starting with pre-engagement procedures and ending with wrap-up procedures.

The unique KBA methodology and Knowledge Coach tool set provides these benefits:

- Seamlessly integrates with ProSystem fx Engagement, reducing the time required to build and populate an audit binder.
- Assists the auditor in refining the audit plan to respond to identified risks and to focus on the areas determined to be significant and subject to the most risk of material misstatement.
- Automatically flows information throughout the audit documents, helping cut down on the time spent duplicating information across forms. In addition, the flow of consistent information ensures that information and updates to information are not missed between workpapers.
- Provides "drill-down" functionality between workpapers, helping the user navigate quickly to the source of the information, aiding in the review of the audit file.
- Provides diagnostic warnings, helping the auditor keep track of many unresolved issues such as: unanswered questions, incomplete risks, unaddressed risks, program steps not linked to risks or relevant assertions, missing workpapers, and more.
- Provides tailoring questions at the beginning of each audit program, assisting the auditor to refine the audit program to only include steps applicable to a particular audit, reducing the chance that auditors in the field perform unneeded tasks.
- Provides direct linkage between identified significant risks and the audit steps performed to address those risks.
- Results in more efficient audits through comprehensive practice aids and engagement resources, such as: illustrative correspondence and audit reports.
- Facilitates the capture and documentation of the required audit information.
- Enhances audit documentation by providing a comprehensive audit documentation checklist.
- Provides direct links to primary source accounting and auditing literature, as well as expert guidance for subscribers of Accounting Research Manager (ARM).



## Using the KBA Methodology: An Example

### Starting an Audit Engagement

Upon the creation of an audit engagement, Knowledge Coach populates the engagement binder with the appropriate foundational workpapers. These workpapers will assist the auditor in documenting the fundamental information required to perform an audit that reduces the risk of material misstatement to an acceptably low level. As workpaper documents are completed, the decisions and judgments made for each financial statement line item identified are carried throughout the tool set. In addition, Knowledge Coach generates diagnostic aids to alert the auditor to potentially unresolved issues.

The benefits of Knowledge Coach are seen with the completion of the very first document in the tool set, the **Tailoring Question Workpaper**. This particular workpaper assists the auditor in streamlining his/her audit efforts from the very beginning and is key to implement the KBA methodology, which guides the auditor through the proper risk assessment. Additionally, the Tailoring Question Workpaper helps the auditor do the appropriate level of work based on the unique characteristics of each audit client and is what drives the scalability of both the KBA methodology and Knowledge Coach workflow.

This workpaper also alerts the auditor to audit programs that should be completed based on their client's circumstances. In this workpaper, the auditor documents information such as, but not limited to:

- Is this a new or continuing engagement?
- Does the entity have multiple locations or subsidiaries?
- Does the entity have an internal audit department?
- Does the entity use service organizations?
- Does the audit require the use of specialist?
- What financial statement line items are applicable to this engagement?

As the auditor completes each of the foundation workpapers, the remaining workpapers are modified to ensure that the auditor continues to capture the appropriate information before continuing on to the next phase of the audit. To facilitate the completion of every phase of the audit, each workpaper includes **Next Step Instructions** to guide the auditor in their efforts.

### Determining Focus

After the auditor has obtained an understanding of the entity and its environment, including entity-level controls, the auditor begins to identify which financial statement line items represent significant audit areas (classes of transactions, account balances and disclosures) and the significant and/or fraud risks associated with each.

These significant audit areas are the ones that contain the most risk of material misstatement and therefore, are the areas in which the auditor should focus their risk assessment, internal control and substantive audit efforts. Knowledge Coach aids the auditor in focusing their efforts by tailoring the subsequent audit documentation to include only these areas, while leaving audit areas identified as not material or as having less risk of material misstatement to be addressed by other audit procedures, such as analytical procedures.

Again, this unique feature of flowing information throughout the audit workpapers helps the auditor stay focused on the most relevant audit areas, resulting in an efficient and effective audit.

### Refining the Audit Program

Once the auditor has documented these decisions, Knowledge Coach begins to tailor the audit plan and direct the auditor's efforts in the required identification of relevant assertions, evaluation of inherent and control risk, and the overall risk of material misstatement for each area determined to be significant or have significant risk. These decisions then flow to the audit programs, where the auditor will capture the audit procedures that need to be performed to address the identified risks. Again, through a series of tailoring questions, the auditor is able to refine the audit program to address only the specific circumstances of his or her client. This truly unique feature ensures that unnecessary audit steps are removed from the audit program, enhancing auditor productivity.

### Maintaining Links and Capturing Updates

Another unique feature of the Knowledge Coach audit programs is that each procedure is linked not only to the relevant assertion it addresses, but directly to the specific risk identified by the auditor. The linkage is often missed in other commercial audit programs that are traditional "flat file" workpapers; but in Knowledge Coach, the linkage is clearly apparent, facilitating not only supervisory and partner reviews of the audit file, but also internal and external engagement quality control reviews.

Along with the diagnostics messages, the Knowledge Coach tool set also includes comprehensive wrap-up programs and practice aids to ensure the proper completion of audit engagements.

During audit engagements, audit documentation is often updated in response to audit comments made during the supervisory and partner reviews of the workpapers. Often, when these updates and changes are made in static "flat file" workpapers, they are not automatically carried forward to future audit periods. This must be done manually. Knowledge Coach removes this risk through its unique ability to flow information from one workpaper to another, including changes made throughout the audit. This feature is truly distinctive to Knowledge Coach and ensures that all the necessary information is captured and rolled forward to the next engagement period.

Knowledge Coach provides a dynamic, interactive and comprehensive approach to financial statement audits that is unique in the industry.

## Conclusion

Designed specifically to help practitioners prevail in the current climate of intense scrutiny, the Knowledge-Based Audit methodology presents the conservative and cost-effective approach needed to conduct a higher-quality audit. Practical discussion and consideration of the day-to-day management of audit engagements enhance the quality of the auditor's practice while easy-to-read and easy-to-understand advice, procedures, and practice aids enable practitioners to put official pronouncements into action immediately.

The Knowledge-Based Audit methodology ensures that the audit engagement meets accounting industry standards, and this is underscored by its peer-reviewed status. Although the KBA methodology provides a framework for applying GAAS, it is not a substitute for knowledge of professional standards and the exercise of auditor skepticism and judgment.

For more information on  
ProSystem fx® Knowledge Coach  
call **800-PFX-9998** (800-739-9998),  
or visit **CCHGroup.com**



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