

Section 8200, *Internal Control*



17. Obtaining an Understanding of Business Processes Relevant to Financial Reporting and Communication

Inquiry—Are auditors required to obtain an understanding of business processes relevant to financial reporting and communication in every audit engagement?

Reply—Yes. AU-C section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement* (AICPA, *Professional Standards*), states that the auditor should obtain an understanding of the information system, including the related business processes and communication relevant to financial reporting.¹

Business processes and communication, which are part of an entity’s information system, are different than the control activities relevant to the audit. Business processes are the activities designed to

- develop, purchase, produce, sell, and distribute an entity’s products and services;
- ensure compliance with laws and regulations; and
- record information, including accounting and financial reporting information.

Business processes result in the transactions that are recorded, processed, and reported by the information system. Obtaining an understanding of the entity’s business processes, which includes how transactions are originated, assists the auditor in obtaining an understanding of the entity’s information system relevant to financial reporting in a manner that is appropriate to the entity’s circumstances.²

It is important for auditors to understand that business processes are different than control activities. Control activities, generally speaking, are those steps put in place by the entity to ensure that the financial transactions are correctly recorded and reported. The auditor is required to obtain an understanding of only those control activities that are considered to be relevant to the audit. Accordingly, there are differing requirements in every audit for obtaining an understanding of business processes versus control activities.

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¹ Paragraph .19 of AU-C section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement* (AICPA, *Professional Standards*).

² Paragraph .A95 of AU-C section 315.

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