

Louwers | Blay | Sinason | Strawser | Thibodeau



Auditing & Assurance Services 7e



Data and Analytics



IDEA
Data Analysis Software

Auditing & Assurance Services

Auditing & Assurance Services

Timothy J. Louwers, PhD, CPA,
CISA, CFF

Director of the School of Accounting and
KPMG Eminent Professor in Accounting

Allen D. Blay, PhD, CPA

Associate Professor of Accounting
Florida State University

David H. Sinason, PhD, CPA, CIA,
CFE, CFSA, CRMA

PwC Professor of Accountancy
Northern Illinois University

Jerry R. Strawser, PhD, CPA

KPMG Chair of Accounting
Texas A&M University

Jay C. Thibodeau, PhD, CPA

Rae D. Anderson Professor of Accounting
Bentley University



AUDITING & ASSURANCE SERVICES, SEVENTH EDITION

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Some people come into our lives and quickly go. Some stay awhile and leave footprints on our hearts and we are never quite the same.

Anonymous

We dedicate this book to the following educators whose footprints we try to follow:

Professor Homer Bates

(University of North Florida)

Professor Stanley Biggs

(University of Connecticut)

Professor Lewis C. Buller

(Indiana State University)

Professor Patrick Delaney

(Northern Illinois University)

Professor William Hillison

(Florida State University)

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(University of Houston)

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Professor Jack Robertson

(University of Texas at Austin)

Professor Robert Strawser

(Texas A&M University)

Professor Sally Webber

(Northern Illinois University)

Professor “IBM Jim” Whitney

(The Citadel)

Meet the Authors



Courtesy James
Madison University

Timothy J. Louwers is the Director of the School of Accounting and KPMG Eminent Professor in Accounting at James Madison University.

Professor Louwers received his undergraduate and master's degrees from The Citadel and his PhD from Florida State University. Prior to beginning his academic career, he worked in public accounting with KPMG, specializing in financial, governmental, and information systems auditing. He is a certified public accountant (South Carolina and Virginia) and a certified information systems auditor. He is also certified in financial forensics.

Professor Louwers's research interests include auditors' reporting decisions and ethical issues in the accounting profession. He has authored or coauthored more than 60 publications on a wide range of accounting, auditing, and technology-related topics, including articles in the *Journal of Accounting Research*, *Accounting Horizons*, the *Journal of Business Ethics*, *Behavioral Research in Accounting*, *Decision Sciences*, the *Journal of Forensic Accounting*, *Issues in Accounting Education*, the *Journal of Accountancy*, the *CPA Journal*, and *Today's CPA*. Some of his published work has been reprinted in Russian and Chinese. He is a respected lecturer on auditing and technology-related issues and has received teaching excellence awards from the University of Houston and Louisiana State University. He has appeared on both local and national television news broadcasts, including MSNBC and CNN news programs.



Courtesy Kallen M. Lunt

Allen D. Blay is an Associate Professor of Accounting at Florida State University.

Professor Blay completed his PhD at the University of Florida in 2000. He teaches auditing at all levels and teaches a seminar in auditing research in the doctoral program. His research interests relate to auditor judgment and decision making. Professor Blay has authored or coauthored publications on a wide range of accounting and auditing topics in journals such as *Contemporary Accounting Research*, *Auditing: A Journal of Practice and Theory*, *Organizational Behavior and Human Decision Processes*, the *Journal of Business Ethics*, *Behavioral Research in Accounting*, *Issues in Accounting Education*, the *International Journal of Auditing*, and the *Journal of Accounting, Auditing, and Finance*. He is currently Associate Editor for *Issues in Accounting Education* and serves on several editorial boards.

Professor Blay has been active in the American Accounting Association, serving on the auditing education committee and the annual meeting committee as Accounting, Behavior, and Organizations section chair, among other committees. He is also active in the American Institute of CPAs, serving in various volunteer roles relating to the Uniform CPA Exam. Prior to entering academics, Professor Blay worked in public accounting auditing financial institutions. He currently directs the accounting doctoral program at Florida State University.



Courtesy Northern Illinois
University

David H. Sinason is the PwC Professor of Accountancy at Northern Illinois University (NIU) and director of the NIU Internal Audit program.

Professor Sinason received a BS in engineering from the University of Illinois, a BS in History from Northern Illinois University, a BBA and MAcc in accounting from the University of North Florida, and a PhD in accounting from Florida State University. He has certifications as a certified public accountant, a certified internal auditor, a certified financial services auditor, and a certified fraud examiner. He also has certification in risk management assurance. Professor Sinason has written more than 50 articles, mostly in the areas of assurance services, fraud prevention and detection, and auditor liability.

Professor Sinason has taught in the areas of accounting information systems, auditing and assurance services, and financial accounting. He has received teaching awards at each of the universities where he has taught including the 2002–2003 Department of Accountancy and Northern Illinois University Awards for Excellence in Undergraduate Teaching.



Courtesy Jerry R. Strawser

Jerry R. Strawser is Executive Vice President and Chief Financial Officer at Texas A&M University and holds the KPMG Chair in Accounting.

Prior to his current appointment, Professor Strawser served as dean of Mays Business School at Texas A&M University, interim executive vice president and provost at Texas A&M University, interim dean of the C. T. Bauer College of Business at the University of Houston, and Arthur Andersen & Co. Alumni Professor of Accounting.

Professor Strawser has coauthored three textbooks and more than 60 journal articles. In addition to his academic experience, he had prior public accounting experience at two Big Five accounting firms. He has also developed and delivered numerous executive development programs to organizations such as AT&T, Centerpoint Energy, Continental Airlines, ConocoPhillips, Halliburton, KBR, KPMG, Minute Maid, PricewaterhouseCoopers, McDermott International, Shell, Southwest Bank of Texas, and the Texas Society of Certified Public Accountants. Professor Strawser is a certified public accountant in the state of Texas and earned his BBA and PhD in Accounting from Texas A&M University.



Courtesy Bentley University

Jay C. Thibodeau is the Rae D. Anderson Professor of Accounting at Bentley University.

Professor Thibodeau is a certified public accountant and a former auditor. He received his bachelor's degree from the University of Connecticut in 1987 and his PhD from the University of Connecticut in 1996. He joined the faculty at Bentley in 1996 and has remained there. At Bentley, he serves as the coordinator for all audit and assurance curriculum matters. His off-campus commitments include consulting with the Audit Learning and Development group at KPMG.

Professor Thibodeau's scholarship focuses on audit judgment and decision making and audit education. He is a coauthor of two textbooks and has written more than 40 book chapters and articles for academics and practitioners in journals such as *Auditing: A Journal of Practice & Theory*, *Accounting Horizons*, and *Issues in Accounting Education*.

Professor Thibodeau served as the President of the Auditing Section of the American Accounting Association for the 2014/2015 academic year. He served on the Executive Committee for the Auditing Section from 2008 to 2010. He has received national recognition for his work five times. First, for his thesis, winning the 1996 Outstanding Doctoral Dissertation Award presented by the ABO section of the AAA. Three other times, for curriculum innovation, winning the 2001 Joint AICPA/AAA Collaboration Award, the 2003 Innovation in Assurance Education Award, and the 2016 Forensic Accounting Teaching Innovation Award. Finally, for outstanding service, receiving a Special Service Award from the Auditing Section for his work in helping to create the "Access to Auditors" program sponsored by the Center for Audit Quality.

Look Beneath the Surface . . .

As auditors, we are trained to investigate beyond appearances to determine the underlying facts—in other words, to *look beneath the surface*. From the Enron and WorldCom scandals of the early 2000s to the financial crisis of 2007–2008 to present-day issues and challenges related to significant estimation uncertainty, understanding the auditor’s responsibility related to fraud, maintaining a clear perspective, probing for details, and understanding the big picture are indispensable to effective auditing. With the availability of greater levels of qualitative and quantitative information (“big data”), the need for technical skills and challenges facing today’s auditor is greater than ever. The author team of Louwers, Blay, Sinason, Strawser, and Thibodeau has dedicated years of experience in the auditing field to this new edition of *Auditing & Assurance Services*, supplying the necessary investigative tools for future auditors.

Cutting-Edge Coverage

The seventh edition of *Auditing & Assurance Services* continues its tradition as the most up-to-date auditing text on the market. All chapters and modules have been revised to incorporate the latest professional standards, recodifications, and proposals from the International Auditing and Assurance Standards Board, Auditing Standards Board, and Public Company Accounting Oversight Board. To acquaint students with the professional standards, each chapter or module begins with a list of the relevant professional standards that are covered in that chapter. Importantly, this text incorporates the reorganized PCAOB standards effective December 31, 2016.

As a team, we use a variety of contacts and resources to stay informed of ongoing developments that affect learning objectives in the financial statement auditing course(s). In fact, changes to key learning goals and objectives are usually prompted by interactions with colleagues from practice.

In that spirit, since the publication of our sixth edition, we have been working hard to stay in touch with developments in practice so we can always respond to your needs in the financial statement auditing classroom. Among our many observations, one trend has emerged as a potential sea change in the financial statement auditing process, the “big data” challenge.

Indeed, based on our collective observations, we believe that students should be prepared to make the best use possible of relevant data using state-of-the-art analytical tools. In fact, the terms *big data* and *data analytics* are frequently being used to describe a growing movement among audit professionals. Our collective view is that students must be prepared to meet the “big data” challenge.

To help students be prepared, the seventh edition of *Auditing & Assurance Services* has been revised deliberately to help students critically think about the use of increased data and analytical tools in the financial statement audit. In addition, we would like to help students learn how to effectively document their conclusions in the current “big data” environment.

In a recent white paper, PwC (2015)¹ lists five “new” skills that will be required of auditors moving forward. Although many of these skills require special statistical or programming knowledge, the first listed skill is one that is applicable to all auditors: “Research and identify anomalies and risk factors in underlying data.” Although

¹“Data Driven: What Students Need to Succeed in a Rapidly Changing Business World.” Available at: <http://www.pwc.com/us/en/faculty-resource/assets/PwC-Data-driven-paper-Feb2015.pdf>.

extraction and analysis from client accounting data are critical skills for newly minted auditors, we are unaware of sufficient materials to assist professors in integrating data analytics into the auditing classroom. Thus, an important goal of the seventh edition is to provide a clear and implementable method to fully integrate a leading data analysis tool, the IDEA data analysis software, into the auditing class.

To start, McGraw-Hill Education is excited to announce a partnership with the developers of the IDEA software. We believe that IDEA provides an outstanding platform to illustrate the steps that auditors need to take related to data and data analysis while completing the financial statement audit. Leading auditing professionals have confirmed that using IDEA is an outstanding way for an entry-level auditing professional to begin the journey into the world of “big data” and “data analytics.” Simply stated, big data is manifested in the financial statement auditing process through the use of tools like IDEA.



Overall, our revisions related to the big data challenge were designed to provide instructors a set of tools and mechanisms to bring data and analytics into the classroom in a meaningful way. Through the use of these tools, students can be sure they are prepared to enter practice with an appreciation for and knowledge of the increasing importance of data and analytics in the auditing profession. We hope that everyone enjoys our attempts to help students get ready for the big data challenge.

Of course, and perhaps most importantly, the seventh edition of *Auditing & Assurance Services* also continues to be the most up-to-date auditing text on the market. The book has fully integrated the reorganized PCAOB Auditing Standards. In addition, all chapters and modules in the seventh edition have been revised to incorporate the two new standards (AS 2701 and AS 2410) adopted by the PCAOB that relate to the auditor’s work on supplementary information provided in the financial statements and related parties. In addition, all chapters and modules have been revised to incorporate the latest updates from the international standards of auditing (ISAs) and the Auditing Standards Board (ASB). With *Auditing & Assurance Services*, seventh edition, students are prepared to take on auditing’s latest challenges.

The Louwers author team uses a conversational, yet professional tone—hailed by reviewers as a key strength of the book.

Flexible Organization

Auditing & Assurance Services teaches students auditing concepts by emphasizing real-life contexts when describing the auditing process. The authors use chapters and modules to

“The format allows you to integrate the modules into the chapter material in any way you would find useful.”

—Frank J. Beil, *University of Minnesota*

Chapters	Modules
The 12 chapters cover the auditing process extensively with a multitude of cases designed to give students a better understanding of how a best-practice concept developed from real-world situations.	Modules A–H provide instructors additional material that can be used throughout the course. Topics such as fraud, ethics, sampling, and technology are covered in the modules, which are designed to be taught whenever instructors want to introduce the topic in their course.

achieve this goal. Although the chapters follow a logical sequence that we recommend professors consider for their classes, **the modules have been written to be used on a stand-alone basis**. In essence, the modules have been deliberately prepared for entirely flexible implementation of these topics without excessive reliance on chapter sequencing. We encourage you to integrate these modules into your syllabi in a manner that best suits your approach to the auditing course.

Engage Your Students with Real Examples

An effective accounting textbook integrates real-world scenarios with theoretical discussion. *Auditing & Assurance Services* places the student in the role of a decision maker, by illustrating the application of auditing concepts using actual situations experienced by accounting firms and companies such as:

Each chapter or module opens with a “real-world” example that draws upon concepts discussed within that chapter or module. Finally, a series of mini-cases have been developed for use by instructors to further bring text material to life. These mini-cases feature real situations experienced by the following companies, individuals, or accounting firms [new cases to the seventh edition are noted with an asterisk (*)].

- Arthur Andersen (failure of auditors to detect fraud at Enron)
- Bernie Madoff Investment Securities (failure of auditors and regulators to detect fraud)*
- Crazy Eddie’s (failure of auditors to detect fraud)*
- Daily Journal Corporation (auditor changes and reporting on internal control)*
- General Electric (audit fees and services provided by auditors)
- General Motors (going-concern report by auditors)
- HealthSouth Corporation (failure of auditors to detect fraud)
- KPMG (competition in the audit marketplace)
- Lehman Brothers (estimation uncertainties in the audit and disclosure concerns)*
- Parmalat (failure of auditors to detect fraud)
- Satyam Computer Services Ltd. (failure of auditors to detect fraud)
- Scott London, KPMG partner (failure of auditor to follow the AICPA Code of Conduct)*

“The tone of the textbook is in a conversational manner that allows for more student-friendly reading material.”

—Aretha Hill, Florida A&M University

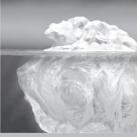
Fraud Awareness

The fraud coverage in *Auditing & Assurance Services* is the most extensive available and is complemented by real-world examples chosen to engage students through the following tools:

- Auditing Insights integrated throughout the text.
- Mini-cases that may be assigned to supplement text chapters and modules that expose students to

CHAPTER 4

Management Fraud and Audit Risk



Profit is the result of risks wisely selected.
Frederick Barnard Hawley, American economist (1843–1929)

Risk comes from not knowing what you’re doing.
Warren Buffett, widely regarded as one of the most successful investors in the world

landmark fraud cases at Bernie Madoff Investment Securities, Enron, HealthSouth, Parmalat, PTL Club, and Satyam Computer Services.

- Specific discussion of management fraud (Chapter 4), employee fraud (Chapter 6), and the Certified Fraud Examiner Exam (Module D).
- **Apollo Shoes Case**, the only stand-alone fraud audit case on the market (available online).

Create a State-of-the-Art Learning Environment: Instructor Resources

The author team and McGraw-Hill are dedicated to providing instructors with the best teaching resources available. In addition to the solutions manual, test bank, and PowerPoint Presentations, and the Apollo Shoe Case, the following resources are also available.

The Updated Auditor

The author team scrutinizes leading business and academic publications for relevant issues and research that sheds light on auditing and the audit process. Recent findings from academic research and discussions from professional literature are drawn from the following publications:

- *Accounting Horizons*
- *Accounting Today*
- *Auditing: A Journal of Practice & Theory*
- *Behavioral Research in Accounting*
- *Bloomberg Businessweek*
- *CFO.com*
- *CPA Journal*
- *Journal of Accountancy*
- *Journal of Accounting and Economics*
- *The Accounting Review*
- *The Wall Street Journal*

These excerpts are highlighted throughout the text as Auditing Insights to allow for easy identification and review by instructors and students.

In addition to the use of Auditing Insights, on a monthly basis, the author team provides an *Updated Auditor* briefing, which summarizes the content of relevant business and academic publications on a chapter-by-chapter basis, to allow students to apply current developments in the profession with material discussed in class. The *Updated Auditor* briefing is available in Connect. With the *Updated Auditor*, instructors will always be at the cutting edge of auditing practice!

IDEA Software and Workbook

With the availability of unprecedented amounts of quantitative and qualitative information and tools available to access and process that information, it is imperative that students learn and utilize the latest technologies used by auditing professionals. As previously stated, McGraw-Hill Education has forged a partnership with Caseware Analytics for the use of the IDEA data analysis tool. Chapters 3 (audit planning), 4 (risk assessment), 5 (internal control), 7–9 (operating cycle chapters), Module F (attributes sampling), and Module G (variables sampling) have been revised to reference the use of IDEA within the chapter or module.

In addition, the seventh edition includes end-of-chapter exercises utilizing **author-developed databases** exclusively for use with *Auditing & Assurance Services* as well as supplemental materials available in Connect to complement the IDEA workbook and provide hands-on instructions on using the IDEA software. The authors also provide implementation guidance to instructors and detailed solutions and explanations on this new content. Overall, the author team has provided significant resources to prepare students for the auditing environment in 2017 and beyond.



Roger CPA Review

McGraw-Hill Education has partnered with Roger CPA Review, a global leader in CPA Exam preparation, to provide students a smooth transition from the accounting classroom to successful completion of the CPA Exam. While many aspiring accountants wait until they have completed their academic studies to begin preparing for the CPA Exam, research shows that those who become familiar with exam content earlier in the process have a stronger chance of successfully passing the CPA Exam. Accordingly, students using these McGraw-Hill materials will have access to sample CPA Exam Multiple-Choice questions and Task-based Simulations from Roger CPA Review, with expert-written explanations and solutions. All questions are either directly from the AICPA or are modeled on AICPA questions that appear in the exam. Task-based Simulations are delivered via the Roger CPA Review platform, which mirrors the look, feel and functionality of the actual exam. McGraw-Hill Education and Roger CPA Review are dedicated to supporting every accounting student along their journey, ultimately helping them achieve career success in the accounting profession. For more information about the full Roger CPA Review program, exam requirements and exam content, visit www.rogercpareview.com.



TestGen

TestGen is a complete, state-of-the-art test generator and editing application software that allows instructors to quickly and easily select test items from McGraw Hill's TestGen testbank content and to organize, edit and customize the questions and answers to rapidly generate paper tests. Questions can include stylized text, symbols, graphics, and equations that are inserted directly into questions using built-in mathematical templates. With both quick-and-simple test creation and flexible and robust editing tools, TestGen is a test generator system for today's educators.

Association to Advance Collegiate Schools of Business (AACSB) Statement

McGraw-Hill Education is a proud corporate member of AACSB International. Understanding the importance and value of AACSB accreditation, *Auditing & Assurance Services, 7e*, recognizes the curricula guidelines detailed in the AACSB standards for business accreditation by connecting selected questions in the text and test bank to the eight general knowledge and skill guidelines in the AACSB standards. The statements contained in *Auditing & Assurance Services, 7e*, are provided only as a guide for the users of this textbook. The AACSB leaves content coverage and assessment within the purview of individual schools, their mission, and their faculty. Although *Auditing & Assurance Services, 7e*, and the teaching package make no claim of any specific AACSB qualification or evaluation, we have within *Auditing & Assurance Services, 7e*, labeled selected questions according to the eight general knowledge and skills areas.

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At McGraw-Hill Education, we understand that getting the most from new technology can be challenging. That's why our services don't stop after you purchase our products. You can contact our Product Specialists 24 hours a day to get product training online. Or you can search the knowledge bank of Frequently Asked Questions on our support website. For Customer Support, call 800-331-5094 or visit www.mhhe.com/support. One of our Technical Support Analysts will be able to assist you in a timely fashion.

New to the Seventh Edition of

In response to feedback and guidance from numerous auditing accounting faculty, the authors have made many important changes to the seventh edition of *Auditing & Assurance Services*, including the following:

Highlights of *Auditing & Assurance Services, 7e*

- The seventh edition of *Auditing & Assurance Services* features Connect and SmartBook.
- All chapter and modules have been revised to incorporate professional standards adopted through May 2016. In addition, the reorganized PCAOB framework (which becomes effective December 31, 2016) has been utilized throughout the text.
- **Auditing Insight boxes** have been added and updated throughout the textbook to place issues discussed within the text into a real-world context. These boxes incorporate numerous examples from business and academic publications as well as actual company annual reports and audit reports.
- Examples using the Caseware IDEA software have been added in Chapters 3, 4, 5, 7, 8, 9, Module F, and Module G. In addition, end-of-chapter exercises using **author-developed databases** exclusively for use with *Auditing &*

Assurance Services as well as supplemental materials to complement the IDEA workbook are provided.

- Coverage in the cycle chapters has been standardized to focus on the risk assessment process for each relevant assertion. In addition, the chapters provide a consistent focus on how auditors respond to assessed risk of material misstatement, through the incorporation of easy-to-read tables throughout Chapters 6 through 10 to highlight the key issues and risks faced by auditors in the examination of different accounts. These tables take the students through the risk assessment process for each cycle on a step-by-step basis to mirror the methodology used in current audit practice.
- Five new Mini-cases have been added that feature Bernie Madoff Investment Securities (failure of auditors and regulators to detect fraud); Crazy Eddie's (failure of auditors to detect fraud); Daily Journal Corporation (auditor changes and internal control reporting); Lehman Brothers (estimation uncertainties in the audit and failure to make informative disclosures); and Scott London, KPMG Partner (failure of auditor to follow the AICPA Code of Conduct).

Part I: The Contemporary Auditing Environment

CHAPTER 1: Auditing and Assurance Services

- Our discussion about the CPA exam has been revised to fully reflect the substantial changes being made to the exam as of April 1, 2017. Due primarily to the outsourcing of routine tasks and significant advances in information technology, the job of a newly licensed CPA has changed. The AICPA responded with a revised exam that has an increased emphasis on higher-order skills like problem solving, critical thinking, and analytical ability. The changes are fully described in the text.
- Increased our emphasis about the importance of audit quality in the current environment and added an Auditing Insight that describes the audit quality indicators project recently completed by the PCAOB in 2015.
- Added a new exhibit that provides an example of the 2014/2015 Sustainability Report for the Coca-Cola Company. We also added a new exhibit that features Mickey Mantle's baseball card from 1961.
- Increased our emphasis on the emergence of big data in the auditing environment and added an Auditing Insight that describes what students need to succeed in a world characterized by big data.

CHAPTER 2: Professional Standards

- Summarized recent academic research related to the impact of PCAOB inspections and results of inspections on audit quality, client attraction and retention, and audit fee growth rates (including research specifically related to the Deloitte vignette in the introduction of this chapter).
- Summarized recent independence issues encountered by EY and KPMG.
- McDonald's 2016 audit report, which demonstrates the contents of an actual audit report and how this report reflects the guidance in the reporting principle.
- Included an Auditing Insight regarding controversy over PCAOB inspection of audits of Alibaba Group Holding Limited, which have been impacted by China's ban of PCAOB inspections.
- Summarized PCAOB inspections of 2012, 2013, and 2014 audits conducted by Big Four firms and expanded analysis to summarize the number of audits in which the client's report on internal control was revised as a result of the inspection.

Auditing & Assurance Services

Part II: The Financial Statement Audit

CHAPTER 3: Engagement Planning

- Added a discussion to emphasize the importance of identifying all of the significant accounts and each of the relevant financial statement assertions during the engagement planning process.
- Included a new table to help facilitate the understanding of significant accounts and relevant financial statement assertions and to show how this might be documented in the audit work papers.
- Added an Auditing Insight to describe the importance of audit quality and why planning is such an important aspect in helping to ensure that the engagement plan has been developed to achieve quality outcomes on the audit.
- Added a discussion about the availability of big data on the audit and included a demonstration problem of how to access a client's data using IDEA.

CHAPTER 4: Management Fraud and Audit Risk

- Increased focus on the importance of assessing the risk of material misstatement for each relevant financial statement assertion for each significant account and disclosure. This focus is entirely consistent with the audit approaches of each of the largest audit firms in the world. This focus will be very helpful in preparing students to enter the auditing environment in 2017 and beyond.
- Added a new easy-to-read table to highlight the importance of identifying “what can go wrong” for each relevant assertion identified in the planning process. This process is instrumental for assessing the risk of material misstatement for each relevant assertion.
- Moved our discussion of an audit client's risk management system to Chapter 5, where it is incorporated into our discussion of the risk assessment component of an effective internal control system as defined by COSO. By moving this section, students are able to better focus on inherent risk assessment in this chapter.
- Added an Auditing Insight to illustrate the potential dangers of analyst expectations at Bankrate and an Auditing Insight to illustrate the difficulty involved in auditing percentage of completion estimates at Toshiba. These examples are used to emphasize the importance of considering a client's business and operating environment during the risk assessment process.
- Incorporated newly released PCAOB Auditing Standard 2410 about Related Parties into the chapter.

CHAPTER 5: Risk Assessment: Internal Control Evaluation

- Fully integrated the specifics of the COSO 2013 update to its internal control framework. The update adds 17 explicit

principles that are associated with the five components of internal control (i.e., control environment, risk assessment, control activities, information and communication, and monitoring). The chapter now includes five new exhibits to help clarify and make these principles salient to students.

- Added a new easy-to-read table to reinforce the importance of identifying “what can go wrong” to help assess the risk of material misstatement for each relevant assertion that provides a foundation to help identify control activities that might mitigate that risk. This is an important aspect of the audit process employed by each of the large audit firms, and the table is designed to help students better understand that process.
- Added a section on internal control testing alternatives with a focus on how auditors can use a tool such as IDEA to test the entire population of control instances in today's environment. We also added two new problems where students can complete exception tests using IDEA.

CHAPTER 6: Employee Fraud and the Audit of Cash

- Added two easy-to-read tables to allow for a focus on the risk assessment process for each relevant assertion related to cash. For each relevant assertion, students can see how the risk of material misstatement was assessed and how the auditors might respond to the assessed risks with tests of control and substantive tests. The step-by-step process mirrors the methodology used in current audit practice.
- Improved the flow and organization of the chapter by integrating the section on controls designed to mitigate the risk of employee fraud into the section on internal control testing for the cash account. In addition, the section on proof of cash has been moved to the extended fraud procedures section to better align the chapter with current audit practice.
- Added an Auditing Insight describing the fraud perpetrated by a controller at a Pepsi-Cola Bottler and how he escaped to the Appalachian trail for an extended period of time.

CHAPTER 7: Revenue and Collection Cycle

- Revised format tracking the audit process beginning with identification of significant accounts and relevant assertions.
- Added four new tables outlining risks and tracking them through the audit process, including tests of controls and substantive procedures.
- Updated discussion of revenue recognition restatements.
- Increased discussion of risks related to data breaches, including an Auditing Insight on the Target Corp. data breach.
- Added a discussion of the new revenue recognition standards, including examples from financial statements of Apple Inc.

- Updated PCAOB inspection findings through the latest inspection reports.
- Includes a focus on data and analytics that integrates several IDEA exercises, including new author-created content and end-of-chapter materials.

CHAPTER 8: Acquisition and Expenditure Cycle

- Revised format tracking the audit process beginning with identification of significant accounts and relevant assertions.
- Added five new tables outlining risks and tracking them through the audit process, including tests of controls and substantive procedures.
- Increased discussion of risks related to accounts payable.
- Updated PCAOB inspection findings through the latest inspection reports.
- Includes a focus on data and analytics that integrates several IDEA exercises, including new author-created content and end-of-chapter materials.

CHAPTER 9: Production Cycle

- Revised format tracking the audit process beginning with identification of significant accounts and relevant assertions.
- Added six new tables outlining risks and tracking them through the audit process, including tests of controls and substantive procedures.
- Extensive discussion of the production process and key reports of interest to the auditors.
- Updated PCAOB inspection findings through the latest inspection reports.
- Includes a focus on data and analytics that integrates several IDEA exercises, including new author-created content and end-of-chapter materials.

CHAPTER 10: Finance and Investment Cycle

- Revised format tracking the audit process beginning with identification of significant accounts and relevant assertions.
- Added five new tables outlining risks and tracking them through the audit process, including tests of controls and substantive procedures.

- Added a new Auditing Insight regarding Verizon’s purchases, including the recent proposed purchase of Yahoo!
- Added a new Auditing Insight describing off-balance-sheet risk for Citigroup.
- Expanded discussion of auditing accounting estimates and fair values, with discussion of extreme estimation uncertainty and an Auditing Insight on the Lehman Brothers collapse.
- Added a discussion of blockchain technology and Bitcoin transactions.
- Updated PCAOB inspection findings through the latest inspection reports.

CHAPTER 11: Completing the Audit

- New introductory vignette discusses Valeant’s year-end financial troubles and the effect on the auditors trying to complete the company’s audit. Added discussion of AS 16’s increased responsibilities to communicate with those charged with governance.

CHAPTER 12: Reports on Audited Financial Statements

- New introductory vignette discusses KPMG’s report on the audit of Rolls-Royce and the identification of critical audit matters in this report.
- Discuss recently approved and proposed standards of audit report disclosures and practices related to critical audit matters, naming of the engagement partner, and audits of group financial statements.
- Summarize recent academic research related to the disclosure of critical audit matters, disclosure of engagement partner identity, receipt and issuance of going concern reports, and inclusion of explanatory paragraphs in otherwise unmodified audit opinions.
- Included examples from recent auditors’ reports of Abbott Laboratories, Alaska Air, Best Buy Co. Inc., Caesars Entertainment Corporation, The Coca-Cola Company, General Electric, Harris Teeter Supermarkets Inc., The Kroger Co., Penske Automotive Group, and Softbank Corp. to illustrate how auditors modify their reports for situations encountered in practice.
- Include results of an Audit Analytics research report summarizing 15 years of data regarding going-concern reports.

Part III: Stand-Alone Modules

MODULE A: Other Public Accounting Services

- New section added on PCAOB broker–dealer standards, including an Auditing Insight describing compliance issues that led to the new standards.

- Updated for the revised standards on accounting and review services, including a section on preparation engagements.
- A new table clarifies the differences between preparation engagements and services that are not preparation engagements.

MODULE B: Professional Ethics

- Opened the module with the story of disgraced former KPMG partner Scott London who sacrificed his career to share confidential client information with a friend.
- Added a discussion of Aristotelian virtue ethics to already existing discussions of Kantian categorical imperatives and utilitarianism.
- Added a discussion of the role of the PCAOB's Division of Enforcement and Investigations.

MODULE C: Legal Liability

- Updated the introductory vignette on litigation involving BDO Seidman for its audits of E.S. Bankest to include the ultimate resolution of this litigation.
- Updated the summary of major settlements involving Big Four accounting firms to include settlements occurring since 2008.
- Expanded the discussion of academic research examining auditor litigation to include recent studies that investigated the factors affecting the litigation risk faced by audit firms.

MODULE D: Internal Audits, Governmental Audits, and Fraud Examinations

- Updated the coverage of the reliance of Congress on the GAO.
- Discussed the variety of services provided by internal auditors.
- Added Benford's law to the fraud investigation discussion.

MODULE E: Overview of Sampling

- New introductory vignette involve the recent U.S. Supreme Court ruling on use of sampling methods to determine monetary damages against Tyson Foods in an employment dispute.
- Revised walk-through example of the use of sampling to address a nonauditing issue.
- Auditing Insight address how sampling risk affected predictions in the 2015 United Kingdom general elections for David Cameron and the Conservative Party.
- Included a brief example of sampling in the evaluation of internal control to illustrate the major steps and decisions made in the sampling process.

MODULE F: Attributes Sampling

- Introductory section provide an overview of the audit engagement, the use of the audit risk model, and the role

of attributes sampling in the audit engagement to place the attributes sampling process in context.

- IDEA is used in the determination of sample size, selection of sample items, and evaluation of sample results to supplement the use of AICPA sampling tables.
- Additional end-of-chapter items provide students with the opportunity to use IDEA in various stages of the attributes sampling process.
- Summarized a recent academic study that surveyed the sampling practices of six international accounting firms with respect to establishing parameters and selecting sample items.

MODULE G: Variables Sampling

- Introductory section provides an overview of the audit engagement, the use of the audit risk model, and the role of variables sampling in the audit engagement to place the variables sampling process in context.
- IDEA is used in the determination of sample size, selection of sample items, and evaluation of sample results to supplement the use of formulae in MUS.
- Additional end-of-chapter items to provide students with the opportunity to use IDEA in various stages of MUS applications.
- Auditing Insight summarize the results of a recent academic study that surveyed the sampling practices of six international accounting firms.
- Previous content on classical variables sampling and nonstatistical sampling has been expanded and relocated into appendixes to provide instructors with flexibility in addressing these topics.

MODULE H: Auditing and Information Technology

- Significantly revised (and simplified) the module throughout to reinforce how the client's use of automated transaction processing systems affects the major stages of the audit team's study and evaluation of internal control.
- Provided an example of how students encounter IT general and app controls when using a smartphone.
- Added additional end-of-chapter material that requires students to identify tests of controls that would be used to evaluate the operating effectiveness of general and automated application controls.



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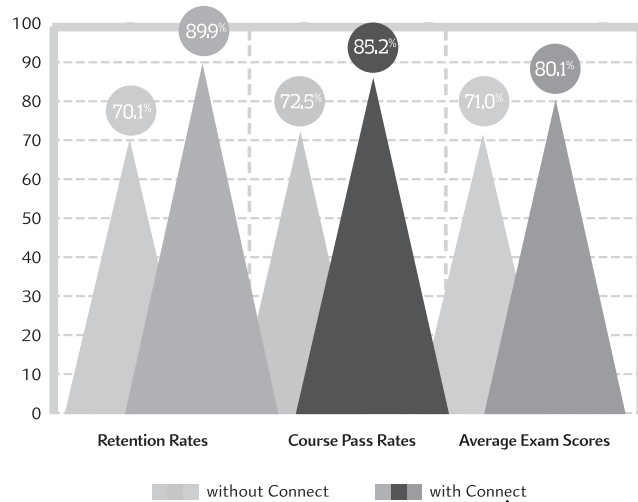
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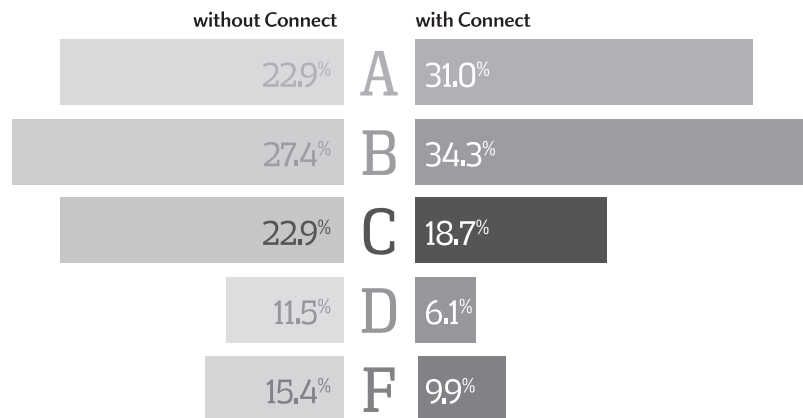
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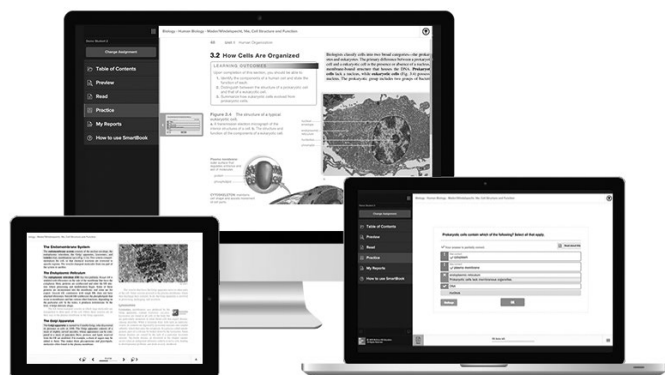
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David Blum,
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Russell F. Briner,
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Northern Illinois University

John Critchett
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*Northern Virginia Community
College at Annandale*

Emily Elaine Griffith,
The University of Georgia

Richard Hale,
Midway College

James Hansen,
University of Illinois at Chicago

Aretha Hill,
Florida A&M University

Steven C. Hunt,
Western Illinois University

Venkataraman Iyer,
*The University of
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George Mason University

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Montana State University–Bozeman

Joseph M. Larkin,
St. Joseph's University

Rose Layton,
University of Southern California

Pamela Legner,
College of DuPage

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Berkeley College

R. D. Licastro,
Penn State University–University Park

Maureen Mascha,
Marquette University

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Northern Kentucky University

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Long Island University Brooklyn

Gary Peters,
University of Arkansas

Byron Pike,
Minnesota State University–Mankato

Marshall Pitman,
University of Texas–San Antonio

Sharon Polansky,
Texas A&M University–Corpus Christi

Kathy Pollock,
*Indiana University–Purdue University
Fort Wayne*

Duane Ponko,
Indiana University of Pennsylvania

Dwayne Powell,
Arkansas State University

Abdul Qastin,
North Carolina A&T State

Linda Quick,
University of South Carolina

Hema Rao,
SUNY–Oswego

Jason T. Rasso,
University of South Florida

Yigal Rechtman,
Pace University

Barbara Reider,
University of Montana

Raymond Reisig,
Pace University

John Rigsby,
Mississippi State University

Pamela Roush,
University of Central Florida

Maria Sanchez,
Rider University

Kristen Kelli Saunders,
University of South Carolina

Tammi Schaefer,
University of South Carolina

Bunney L. Schmidt,
Utah Valley State College

Timothy Andrew Seidel,
University of Arkansas

Carol Shaver,
Louisiana Tech University

Jaysinha Shinde,
Eastern Illinois University

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California State University

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University of Memphis

Frank Venezia,
State University at Albany

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Brief Contents

PART ONE

The Contemporary Auditing Environment

1. Auditing and Assurance Services 1
2. Professional Standards 40

PART TWO

The Financial Statement Audit

3. Engagement Planning 75
4. Management Fraud and Audit Risk 117
5. Risk Assessment: Internal Control Evaluation 173
6. Employee Fraud and the Audit of Cash 227
7. Revenue and Collection Cycle 279
8. Acquisition and Expenditure Cycle 336
9. Production Cycle 394
10. Finance and Investment Cycle 443
11. Completing the Audit 500
12. Reports on Audited Financial Statements 540

PART THREE

Stand-Alone Modules

Please refer to pages xviii–xxiii for guidance on when to best integrate these modules.

- A. Other Public Accounting Services 583
- B. Professional Ethics 628
- C. Legal Liability 676
- D. Internal Audits, Governmental Audits, and Fraud Examinations 720
- E. Overview of Sampling 762
- F. Attributes Sampling 795
- G. Variables Sampling 835
- H. Auditing and Information Technology 883

CASES C1

INDEX I1

Contents

PART ONE

THE CONTEMPORARY AUDITING ENVIRONMENT

Chapter 1

Auditing and Assurance Services 1

User Demand for Reliable Information 2

Information Risk in a Big Data World 3

Auditing, Attestation, and Assurance Services 4

Definition of Financial Statement Auditing 5

Auditing in a Big Data Environment 6

Attestation Engagements 7

Assurance Services 9

Examples of Assurance Services 10

Management's Financial Statement Assertions 12

Existence or Occurrence (Existence, Occurrence) 13

Rights and Obligations

(Rights and Obligations) 14

Completeness (Completeness, Cutoff) 15

Valuation and Allocation (Accuracy or

Valuation) 15

Presentation and Disclosure (Classification,

Understandability) 15

Importance of Assertions 17

Professional Skepticism 18

Public Accounting 21

Assurance Services 21

Tax Services 23

Consulting and Advisory Services 23

Other Kinds of Engagements and Information

Professionals 24

Internal Auditing 24

Governmental Auditing 25

Regulatory Auditors 26

Become a Professional and Get Certified! 26

Education 27

Examination 27

Experience 28

State Certificate and License 29

Skill Sets and Your Education 30

Summary 31

Key Terms 31

Multiple-Choice Questions for Practice and Review 32

Exercises and Problems 37

Chapter 2

Professional Standards 40

Introduction 41

Generally Accepted Auditing Standards (GAAS) 42

Fundamental Principle: Responsibilities 45

Fundamental Principle: Performance 48

Fundamental Principle: Reporting 54

Evaluating the Quality of Public Accounting Firms' Practices 56

System of Quality Control 56

PCAOB Inspection of Firms 58

Summary 60

Key Terms 61

Multiple-Choice Questions for Practice and Review 63

Exercises and Problems 66

Appendix 2A

Referencing Professional Standards 73

PART TWO

THE FINANCIAL STATEMENT AUDIT

Chapter 3

Engagement Planning 75

Introduction 76

Pre-Engagement Activities (AU-C 300, AS 2101) 77

Client Acceptance or Continuance 77

Compliance with Independence and Ethical

Requirements 79

Engagement Letters 80

Audit Plan (AU-C 300, AS 2101) 82

Staffing the Audit Engagement 83

Considering the Work of Internal Auditors

(AU-C 610, AS 2605) 84

Using the Work of an Audit Specialist

(AU-C 620, AS 1210) 85

Use of IT Auditors 85

Time Budget 85

Materiality (AU-C 320, AS 2105) 87

Materiality Calculation 89

Audit Procedures for Obtaining Audit

Evidence (AU-C 500, AS 1105) 90

1. Inspection of Records and Documents 93

2. Inspection of Tangible Assets 96

3. Observation	96
4. Inquiry	96
5. Confirmation	97
6. Recalculation	97
7. Reperformance	97
8. Analytical Procedures	98
Planning in a Computerized Environment	99
<i>Effect of Client's Computerized Processing on Audit Planning</i>	100
<i>Computer-Assisted Audit Techniques (CAATs)</i>	102
Audit Documentation (AU-C 230, AS 1215)	104
<i>Permanent Files</i>	104
<i>Current Files</i>	105
<i>Audit Documentation Arrangement and Indexing</i>	106
Summary	108
Key Terms	109
Multiple-Choice Questions for Practice and Review	110
Exercises and Problems	114

Chapter 4

Management Fraud and Audit Risk 117

Introduction	118
Audit Risk (AU 320, AS 1101)	119
<i>Audit Risk</i>	119
<i>Inherent Risk</i>	120
<i>Control Risk</i>	120
<i>Detection Risk</i>	120
<i>Audit Risk Model</i>	120
Fraud Risk (AU-C 240, AS 2401)	124
<i>Fraud</i>	126
<i>Types of Fraud</i>	128
<i>Other Definitions Related to Fraud</i>	128
Inherent Risk Assessment—"What Could Go Wrong?" (AU 315, AS 2110)	130
<i>Understanding the Client's Business and Its Environment</i>	132
<i>Industry, Regulatory, and Other External Factors</i>	132
<i>The Nature of the Company</i>	133
<i>Related Parties</i>	133
<i>Selection and Application of Accounting Principles, Including Related Disclosures</i>	134
<i>Company Objectives, Strategies, and Related Business Risks</i>	135
<i>Company Performance Measures</i>	137
Gathering Information and Preliminary Analytical Procedures	137
<i>General Business Sources</i>	137
<i>Company Sources</i>	138
<i>Information from Client Acceptance or Continuance Evaluation, Audit Planning, Past Audits, and Other Engagements</i>	138
<i>Preliminary Analytical Procedures (AU 520, AS 2110)</i>	138
<i>Audit Team Brainstorming Discussions</i>	144

<i>Inquiry of Audit Committee, Management, and Others within the Company</i>	145
Overall Assessment and Documentation of Inherent Risk Assessment (AU 500, AS 1105, AU 265, AS 2201)	146
<i>Document Risk Assessment</i>	147
<i>Fraud and Other Significant Risks (AU 330, AS 2301)</i>	147
<i>Communication of Fraud Risks</i>	148
Auditors' Responsibilities for Noncompliance with Laws and Regulations (AU 250, AS 2405)	149
Audit Strategy Memorandum	151
Summary	152
Key Terms	152
Multiple-Choice Questions for Practice and Review	154
Exercises and Problems	158
Appendix 4A	
Selected Financial Ratios	169

Appendix 4B

Sample Audit Memorandum 170

Chapter 5

Risk Assessment: Internal Control Evaluation 173

Introduction	174
Internal Control Defined	175
Management Versus Auditors' Responsibility for Internal Control	176
<i>Auditors' Internal Control Responsibilities</i>	176
Components of Internal Control	179
<i>Control Environment</i>	180
<i>Risk Assessment</i>	181
<i>Control Activities</i>	183
<i>Information and Communication</i>	187
<i>Monitoring</i>	188
<i>Limitations of Internal Control</i>	190
Internal Control Evaluation	191
<i>Phase 1: Understand and Document the Client's Internal Control</i>	192
<i>Phase 2: Assess the Control Risk (Preliminary)</i>	197
<i>Phase 3: Identify Controls to Test and Perform Tests of Controls</i>	199
Responsibilities in Public Company Audits Required by PCAOB Auditing Standard No. 2201	203
<i>Requirements</i>	204
Internal Control Communications	207
Summary	208
Key Terms	209
Multiple-Choice Questions for Practice and Review	210
Exercises and Problems	214
Appendix 5A	

Audit Plan 220**Appendix 5B****Auditor Reports on Internal Control over Financial Reporting 220****Chapter 6****Employee Fraud and the Audit of Cash 227**

Introduction 228

*Employee Fraud Overview 229**Employee Fraud Red Flags 230**Characteristics of Fraudsters 230*

The Fraud Triangle (AU-C 315, AS 2401) 232

*Incentive/Pressure 233**Opportunity 233**Attitude/Rationalization 234*

Fraud Prevention 235

*Managing People and Pressures in the Workplace 235**Internal Control Activities and Employee**Monitoring 236**Tone at the Top 238*

The Audit of Cash 239

*Audit Evidence Used to Test Cash 239**Significant Accounts and Relevant Assertions 243**Risk of Material Misstatement 244**Evaluating the Design and Operating Effectiveness of Internal Controls 244**Substantive Procedures 250*

“Extended Procedures” to Detect Fraud 257

Summary 260

Key Terms 261

Multiple-Choice Questions for Practice and Review 262

Exercises and Problems 265

Appendix 6A**Internal Control Questionnaires 276****Appendix 6B****Audit Plans 278****Chapter 7****Revenue and Collection Cycle 279**

Introduction 280

Revenue and Collection Cycle: Typical Activities 280

*Receiving and Processing Customer Orders, Including Credit Granting 281**Delivering Goods and Services to Customers 282**Billing Customers and Accounting for Accounts Receivable 282**Management Reports and Data Files in the Revenue and Collection Cycle 283*

Significant Accounts and Relevant Assertions 285

Risk of Material Misstatement 287

*Revenue Recognition 287**Collectability of Accounts Receivable 290**Customer Returns and Allowances 290*

Internal Control Activities and Design Evaluation 290

*Entity-Level Controls in the Revenue and Collections Cycle 291**Control Considerations at the Account and Assertion Level 291*

Tests of Operating Effectiveness of Internal Control 293

Summary: Control Risk Assessment 296

Substantive Analytical Procedures and Tests of Details 297

*Analytical Procedures 300**Confirmation of Accounts and Notes Receivable 301**Alternative Procedures 305**Additional Notes about Confirmations 306**Dual-Purpose Nature of Accounts Receivable Confirmations 306**Review for Collectability 306**Cutoff and Sales Returns 307*

Audit Risk Model Applied 309

Application in the Field 309

Audit Cases: Extended Audit Procedures (AS 2301) 310

Summary 317

Key Terms 317

Multiple-Choice Questions for Practice and Review 318

Exercises and Problems 322

Appendix 7A**Internal Control Questionnaires 332****Appendix 7B****Audit Plan 334****Chapter 8****Acquisition and Expenditure Cycle 336**

Introduction 337

Acquisition and Expenditure Cycle: Typical Activities 338

*Purchasing Goods and Services 338**Receiving the Goods or Services 340**Recording the Asset or Expense and Related Liability 341*

Significant Accounts and Relevant Assertions 341

*Accounts Payable 342**Expenses 343*

Risk of Material Misstatement 344

Internal Control Activities and Design Evaluation 346

*Entity-Level Controls 346**Control Considerations 346*

<i>Custody</i>	348
<i>Periodic Reconciliation</i>	348
Testing of Operating Effectiveness of Internal Control	349
<i>Tests of Controls</i>	349
Substantive Analytical Procedures and Tests of Details	351
<i>Open Purchase Orders</i>	351
Audit Risk Model Applied	359
Fraud Cases: Extended Audit Procedures (ISA/AS 2301)	361
Audit Issues in the Expense and Acquisition Cycle	364
Summary	365
Key Terms	365
Multiple-Choice Questions for Practice and Review	366
Exercises and Problems	369
Appendix 8A	
Internal Control Questionnaires	377
Appendix 8B	
Audit Plans	380
Appendix 8C	
The Payroll Cycle	382
Multiple-Choice Questions for Practice and Review	390
Exercises and Problems	392
Chapter 9	
Production Cycle	394
Phar-Mor Inc.	395
Production Cycle: Typical Activities	396
Significant Accounts and Relevant Assertions	400
Risk of Material Misstatement	402
Internal Control Activities and Design Evaluation	404
Testing of Operating Effectiveness of Internal Control	408
Substantive Analytical Procedures and Tests of Details	411
<i>Inventory Circumstances</i>	416
Audit Risk Model Applied	421
<i>Fraud Case: Extended Audit Procedures (AS 2301)</i>	421
Summary	423
Key Terms	425
Multiple-Choice Questions for Practice and Review	426
Exercises and Problems	429
Appendix 9A	
Internal Control Questionnaires	439
Appendix 9B	
Audit Plans	441

Chapter 10	
Finance and Investment Cycle	443
Introduction	444
Finance and Investment Cycle: Typical Activities	445
<i>Financing the Entity through Debt and Stockholder Equity</i>	446
<i>Financial Planning (1)</i>	447
<i>Raising Capital (2)</i>	447
<i>Investing Transactions: Investments and Intangibles (3)</i>	449
Significant Accounts and Relevant Assertions	452
Risk of Material Misstatement	453
<i>Fair Market Value</i>	454
<i>Related-Party Transactions</i>	455
<i>Lease Accounting</i>	455
<i>Loan Covenants</i>	456
<i>Impairments</i>	457
<i>Presentation and Disclosure</i>	457
Internal Control Activities and Design Evaluation	458
<i>Control Considerations</i>	460
Tests of Operating Effectiveness of Internal Control	460
<i>Control over Accounting Estimates</i>	463
<i>Authorization</i>	464
<i>Record Keeping</i>	464
<i>Custody</i>	465
<i>Summary: Control Risk Assessment</i>	465
Substantive Analytical Procedures and Tests of Details	466
<i>Auditing Fair Value Measurements (AS 2502)</i>	472
<i>Derivative Instruments, Hedging Activities, and Investments in Securities (AS 2503)</i>	473
<i>Long-Term Liabilities and Related Accounts</i>	474
<i>Stockholders' Equity: Substantive Procedures</i>	476
<i>Auditing Stock-Based Compensation Plans</i>	476
Fraud Cases: Extended Audit Procedures (AS 2301)	477
Summary	482
Key Terms	484
Multiple-Choice Questions for Practice and Review	484
Exercises and Problems	488
Appendix 10A	
Internal Control Questionnaires	496
Appendix 10B	
Substantive Audit Plans	497
Chapter 11	
Completing the Audit	500
Introduction	501
Audit Timeline	502
Procedures Performed During Fieldwork	504

<i>Completing Substantive Procedures</i>	504
<i>Attorney Letters</i>	505
<i>Written Representations</i>	509
<i>Ability to Continue as a Going Concern</i>	512
<i>Adjusting Entries and Financial Statement Disclosure</i>	513
<i>Audit Documentation Review</i>	516
Subsequent Events and Subsequently Discovered Facts	517
<i>Subsequent Events</i>	517
<i>Subsequently Discovered Facts</i>	519
Responsibilities Following the Audit Report Release Date	521
<i>Omitted Procedures</i>	521
<i>Communications with Individuals Charged with Governance</i>	521
<i>Management Letter</i>	523
<i>Summary of Audit Communications</i>	523
Summary	524
Key Terms	524
Multiple-Choice Questions for Practice and Review	525
Exercises and Problems	528

Chapter 12

Reports on Audited Financial Statements 540

Introduction	541
Overview of Auditors' Reports	542
<i>The Standard Report</i>	543
<i>Auditors' Reports for Public Entities</i>	544
<i>Types of Opinions</i>	546
Conditions That Require Modifications to the Auditors' Standard (Unmodified) Report	547
<i>Departures from GAAP</i>	547
<i>Scope Limitations</i>	549
Audits of Group Financial Statements	553
Auditors' Reports Referencing Other Matters Encountered During the Audit	556
<i>Consistency</i>	556
<i>"Going-Concern" Uncertainties</i>	556
<i>Other Information Accompanying Audited Financial Statements</i>	557
<i>Required Supplementary Information</i>	558
<i>Other Modifications</i>	559
<i>Summary: Emphasis-of-Matter and Other-Matter Paragraphs</i>	559
Other Reporting Topics	560
<i>Comparative Financial Statements</i>	560
<i>Summary Financial Statements</i>	562
<i>Supplementary Information</i>	563
<i>Disclaimers of Opinion</i>	563
Summary	564
Key Terms	566

Multiple-Choice Questions for Practice and Review	567
Exercises and Problems	569

PART THREE

STAND-ALONE MODULES

Module A

Other Public Accounting Services 583

Introduction	585
Attestation Engagements	585
<i>Introduction to Attestation Engagements</i>	585
<i>Applying Agreed-Upon Procedures</i>	588
<i>Prospective Financial Information and Pro Forma Financial Information</i>	588
<i>An Examination of an Entity's Internal Control over Financial Reporting That Is Integrated with an Audit of Its Financial Statements (AT 501)</i>	590
<i>Compliance Attestation</i>	591
<i>Broker-Dealer Compliance</i>	592
<i>Management's Discussion and Analysis</i>	594
<i>Service Organizations</i>	594
Unaudited Financial Statements: Reviews, Compilations, and Preparation Engagements	598
<i>Review Services</i>	598
<i>Compilation Services</i>	602
<i>Preparation of Financial Statements</i>	603
<i>Summary of Audits, Reviews, and Compilations</i>	604
Responsibilities Related to Reporting on Interim Financial Information	604
Other Topics: Special and Restricted-Use Reports	606
<i>Specified Elements, Accounts, or Items</i>	606
<i>Special-Purpose Frameworks</i>	607
<i>Reports on Application of Requirements of an Appropriate Financial Reporting Framework</i>	609
Assurance Services	611
<i>Why Develop New Assurance Services?</i>	611
<i>Definition: Assurance Services</i>	612
<i>eXtensible Business Reporting Language (XBRL)</i>	613
<i>Enhanced Business Reporting</i>	613
<i>Integrated Reporting</i>	613
<i>Trust Services</i>	614
<i>Sustainability Reporting</i>	615
Summary	616
Key Terms	617
Multiple-Choice Questions for Practice and Review	618
Exercises and Problems	621

Module B

Professional Ethics 628

Introduction	629
General Ethics	630