

Louwers | Bagley | Blay | Strawser | Thibodeau

An iceberg floating in the ocean. The tip of the iceberg is visible above the water surface, while the much larger, submerged part is visible below. The water is a deep blue, and the sky is a lighter blue with some clouds. The text is overlaid on the submerged part of the iceberg.

Auditing & Assurance Services 8e

**Mc
Graw
Hill**

Data and Analytics



IDEA

Data Analysis Software



Auditing & Assurance Services

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

Professor Emeritus
James Madison University

Penelope L. Bagley, PhD, CPA

Department Chair and
Professor of Accounting
Appalachian State University

Allen D. Blay, PhD, CPA

Denise Dickins Accounting Faculty
Fellow and Associate Professor
Florida State University

Jerry R. Strawser, PhD, CPA

KPMG Chair and Professor of Accounting
Texas A&M University

Jay C. Thibodeau, PhD, CPA

Rae D. Anderson Professor of Accounting
Bentley University





AUDITING & ASSURANCE SERVICES, EIGHTH 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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Professor Richard Kochanek

(University of Connecticut)

Professor John L. “Jack” Kramer

(University of Florida)

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 of James Madison University

Timothy J. Louwers is Professor Emeritus 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 of Kallen M. Lunt

Allen D. Blay is an Associate Professor of Accounting and the Denise Dickins Accounting Faculty Fellow 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 an editor for *Issues in Accounting Education* and serves on several editorial boards.

Professor Blay has been active in the American Accounting Association, co-chairing the 2020 Auditing Section Midyear Meeting and serving on the steering committee for the Intensive Data and Analytics Summer Workshop the past three years, as well as in many other roles over the years. 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 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 Four 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, Pricewaterhouse-Coopers, 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.



Bentley University

Jay C. Thibodeau is the Rae D. Anderson Professor of Accounting and Director of PhD Programs 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 ever since. Professor Thibodeau has conducted executive education programs for numerous leading firms including Fidelity Investments, KPMG, PricewaterhouseCoopers, Stryker, and Blue Coat Technologies.

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 50 book chapters and articles for academics and practitioners in journals such as *Auditing: A Journal of Practice & Theory*, *Journal of Information Systems*, *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 has received national recognition for his work six times: First, for his thesis, winning the 1996 Outstanding Doctoral Dissertation Award presented by the ABO section of the AAA. Four other times, for curriculum innovation, winning the 2001 Joint AICPA/AAA Collaboration Award, the 2003 Innovation in Assurance Education Award, the 2016 Forensic Accounting Teaching Innovation Award, and the 2019 Innovation in Assurance Education Award. And finally, for outstanding service, receiving a Special Service Award from the Auditing Section for his work in helping to create the Center for Audit Quality's Access to Auditors program.



Penelope L. Bagley

Penelope L. Bagley is the Department Chairperson and Professor of Accounting at Appalachian State University.

Professor Bagley received her undergraduate and master's degrees from North Carolina State University and her PhD at the University of Georgia. Prior to obtaining her PhD, Professor Bagley worked for a short time in the audit field. She is a certified public accountant in North Carolina. Professor Bagley teaches both undergraduate and graduate auditing courses. Professor Bagley has authored and co-authored publications on accounting and auditing topics in journals such as *Auditing: A Journal of Practice & Theory*, *Accounting Horizons*, and *Behavioral Research in Accounting*. She has also co-authored auditing cases, published in *Issues in Accounting Education*. Professor Bagley is active in the American Accounting Association and has served on various committees for the Auditing Section. Professor Bagley likes to spend time with her husband Matt and children, Garrett and Julianne. She is an avid runner, most recently qualifying for and running the 2019 Boston Marathon.

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 Louwers, Bagley, Blay, Strawser, and Thibodeau team 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 eighth 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**.
- A list of the relevant professional standards that are covered in that chapter, including **new AICPA reporting standards effective for 2020** fiscal years, as well as comprehensive coverage of the **new PCAOB standards on auditing estimates**.

Data Analytics

- One trend has emerged as a potential sea change in the financial statement auditing process: **the data and analytics challenge**.

We believe 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 and analytics* are frequently being used to describe a growing movement among audit professionals. As the AICPA moves to add data and analytics onto the Uniform CPA Examination, our collective view is that students must be able to not only meet current requirements, but be ahead of the game.

To prepare students, the eighth 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 to changes within the main chapters of the book, we have added

- **A new module specifically covering data and analytics in auditing**, which follows the AICPA Guide to Data Analytics.
- **Author-Created Cases and Exercises** (as part of **Data Analytics Module**) that cover the majority of uses of data analytics in the financial statement audit, along with **extensive solutions** to help instructors implement the materials in their classroom.

It is our belief that students should be trained in the process of data and analytics, and learn to think critically about situations they may face in an audit. We believe that the knowledge students attain should be software independent, particularly since software

technology changes so rapidly. However, we also believe that it is important for students to become familiar with at least one specific data and analytic software tool, and recent AACSB standards echo this belief. Thus, an important goal of the eighth 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. *Many of our exercises, however, can be implemented using whatever technology an instructor chooses to use, like Excel.*

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 entry-level auditing professionals 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.

Perhaps most importantly, the eighth 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 new PCAOB and ASB reporting standards**. In addition, we fully cover the **PCAOB’s new standards on audits of estimates**, including **fair value estimates**, and the use of **specialists in an audit**. 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*, eighth 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.
- A series of mini-cases available on the Instructor Resource Center have been developed for use by instructors to further bring text material to life. These mini-cases feature real situations experienced by companies, individuals, or accounting firms and are updated by the authors to include both timeless classics such as Arthur Andersen’s failure to detect fraud at Enron to more recent situations such as Lehman Brothers.

The Audit Risk Model and Inherent Risk Assessment

CHAPTER 4

Profit is the result of risks wisely selected.
Frederick Barnard Hawley.

Risk comes from not knowing what you’re doing.
Warren Buffett.

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 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).

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, 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), both modules on sampling (Modules E and F), and the new data and analytics module (Module G) have been revised to reference the use of IDEA within the chapter or module.



In addition, the eighth 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.
- Robust video walk-throughs.
- Detailed solutions and explanations on this new content.

Overall, the author team has provided significant resources to prepare students for the auditing environment in 2020 and beyond.

Updated Classroom Cases

The author-prepared *Updated Classroom Cases* provides students and instructors with a brief overview of “real-time” auditing issues, along with references to suggested readings and guidelines for incorporating the content into the classroom. Previous items have featured the KPMG “Steal the Exam” issue related to PCAOB inspections and the 2018 ban of PwC for audits of companies listed on the India Stock Exchange. New items are added as events develop and are available in *Connect*.

Standards Update

The professional standards facing auditors continue to evolve. The author-prepared *Standards Update* provides a summary of current exposure drafts and pronouncements issued subsequent to the publication of the text. This invaluable resource provides students and instructors with an “evergreen” text and summarizes the most current activities of the Auditing Standards Board and Public Company Accounting Oversight Board. The *Standards Update* is updated bi-annually and available in *Connect*.

Highlights of *Auditing & Assurance Services, 8e*

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

- The eighth edition of *Auditing & Assurance Services* features Connect and SmartBook.
- A new Module G has been added to include full coverage of the uses of **Data and Analytics** in auditing, including extensive **Data Analytics Exercises** with **author-created data**.
- All chapters and modules have been revised to incorporate professional standards adopted through January 2020.
- **New Update to Apollo Shoes, Inc.** case with **Data Analytics** content. Apollo Shoes, Inc. is an audit case designed to introduce students to the entire audit process. Newly created auto-gradable questions, instructor implementation guide, and videos can be found online in Connect.
- **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 are included in Chapters 3, 4, 5, 7, 8, 9, Module E, Module F, and the new Module G focusing on **Data and Analytics**. 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.
- Tables in the cycle chapters have been fully standardized to focus on the risk assessment process for each relevant assertion. 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.

Remote Proctoring & Browser-Locking Capabilities



New remote proctoring and browser-locking capabilities, hosted by Proctorio within Connect, provide control of the assessment environment by enabling security options and verifying the identity of the student.

Seamlessly integrated within Connect, these services allow instructors to control students' assessment experience by restricting browser activity, recording students' activity, and verifying students are doing their own work.

Instant and detailed reporting gives instructors an at-a-glance view of potential academic integrity concerns, thereby avoiding personal bias and supporting evidence-based claims.

Tegrity: Lectures 24/7

Tegrity in Connect is a tool that makes class time available 24/7 by automatically capturing every lecture. With a simple one-click start-and-stop process, you capture all computer screens and corresponding audio in a format that is easy to search, frame by frame. Students can replay any part of any class with easy-to-use, browser-based viewing on a PC, Mac, iPod, or other mobile device.

Educators know that the more students can see, hear, and experience class resources, the better they learn. In fact, studies prove it. Tegrity's unique search feature helps students efficiently find what they need, when they need it, across an entire semester of class recordings. Help turn your students' study time into learning moments immediately supported by your lecture. With Tegrity, you also increase intent listening and class participation by easing students' concerns about note-taking. Using Tegrity in Connect will make it more likely you will see students' faces, not the tops of their heads.

Test Builder in Connect

Available within Connect, Test Builder is a cloud-based tool that enables instructors to format tests that can be printed or administered within a Learning Management System (LMS). Test Builder offers a modern, streamlined interface for easy content configuration that matches course needs, without requiring a download.

Test Builder allows you to:

- access all test bank content from a particular title.
- easily pinpoint the most relevant content through robust filtering options.
- manipulate the order of questions or scramble questions and/or answers.
- pin questions to a specific location within a test.
- determine your preferred treatment of algorithmic questions.
- choose the layout and spacing.
- add instructions and configure default settings.

Test Builder provides a secure interface for better protection of content and allows for just-in-time updates to flow directly into assessments.

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*, 8e, 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*, 8e, 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*, 8e, and the teaching package make no claim of any specific AACSB qualification or evaluation, we have within *Auditing & Assurance Services*, 8e, labeled selected questions in Connect according to the eight general knowledge and skills areas.



Roger CPA Review

McGraw-Hill has partnered with Roger CPA Review (Powered by UWorld), 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 Roger CPA Review multiple choice questions supported by explanations written by CPAs focused on exam preparation. McGraw-Hill and Roger CPA Review are dedicated to supporting all accounting students 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.

New to the Eighth Edition of *Auditing & Assurance Services*

Part I: The Contemporary Auditing Environment

The following breakdown shows the revisions we made on a chapter-by-chapter basis:

CHAPTER 1: Auditing and Assurance Services

- Updated the section on the importance of reliable information for users by incorporating a discussion about **Theranos**, the blood-testing startup company that was recently featured in an HBO movie. In many cases, the informational package provided to potential investors did not include an independent audit report. The example reinforces why it is so important for investors and creditors to review audited financial statements as they consider whether to invest or loan money to a company.
- Included a new Auditing Insight featuring the most recent audit quality report published by KPMG. Importantly, the report highlighted the firm's investment in the audit of the future and included a discussion of cognitive technologies such as IBM's Watson and the importance of harnessing the emerging power of Big Data.
- Included a new Auditing Insight that describes the role of **EY**, a Big Four accounting firm, in the annual Hall of Fame voting for baseball. That is, while the Baseball Writers' Association of America

is responsible for the voting, EY is responsible for verifying that eligible voters are properly registered and have signed a code of conduct, and that the actual count of votes is correct!

CHAPTER 2: Professional Standards

- Added opening vignette describing the Deloitte Brazil audits of Gol Intelligent Airlines and alteration of documentation in response to a PCAOB inspection.
- Added Auditing Insights related to the Carillion audit failure, the United Kingdom Competition and Markets Authority recommendations for auditor independence, and the KPMG controversy related to advance notification of audits selected for PCAOB inspection.
- Included a summary of recent academic research relating to the impact of PCAOB inspection results on auditor dismissal, auditor market share and fees, auditor opinions, audit quality, and audit effort in years following the inspection.
- Included 2019 auditors' report for Microsoft, one of the first major companies to be subject to disclosure of critical audit matters in the auditors' report.
- Summarized PCAOB inspections of 2015, 2016 and 2017 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.

Part II: The Financial Statement Audit

CHAPTER 3: Engagement Planning

- Updated planning discussion for changes related to the updated PCAOB Auditing Standard 1210: Using the Work of an Auditor-Engaged Specialist, effective for FYE 12/15/2020 and amendments to Auditing Standard 1105: Audit Evidence and Audit Standard 1201: Supervision of the Audit Engagement.
- Integrated discussion of matters of planning related to the client's computer environment and the use of CAATs (former LO 3-5) into the chapter and remainder of the text.
- Introduced a new vignette reflecting current audit environment and independence concerns.
- Rearranged and updated discussions on Staffing the Audit Engagement and Materiality for readability and flow.

- Updated and replaced Audit Insights and examples throughout the chapter to reflect more recent events.

CHAPTER 4: The Audit Risk Model and Inherent Risk Assessment

- Renamed the chapter to better reflect the chapter content.
- Introduced a new vignette discussing recent PCAOB inspection reports and their continued focus on issues related to audit risk assessment.
- Added a discussion in Inherent Risk Assessment to reflect the need for the auditor to also understand the client's computerized processing when gaining an understanding of the client's business and environment.
- Replaced and updated Audit Insights and examples throughout the chapter to reflect more recent events.

CHAPTER 5: Risk Assessment: Internal Control Evaluation

- Revised the introduction to include the recent “cease and desist” orders issued by the SEC (January 2019) against four public companies: Lifeway Foods Inc., Digital Turbine Inc., CytoDyn Inc., and Grupo Simec S.A.B de C.V. After providing each of these companies with as many as 10 years to address their problems, the SEC finally had enough and decided to take action. In taking this action, the SEC made clear that “disclosure of material weaknesses is not enough without meaningful remediation. We are committed to holding corporations accountable for failing to timely remediate material weaknesses.” The introduction allows for instructors to emphasize the importance of the internal control audit in their classes
- Added an Auditing Insight that featured, Elon Musk, the billionaire co-founder of Tesla Inc., who was fined \$20 million by the SEC for a seemingly harmless tweet that he made on August 7, 2018. The tweet indicated that he had secured financing to take the company public, causing an increase of over six percent in the company’s stock price. The basis of the SEC’s complaint against Tesla related back to a lack of internal controls.
- Replaced the Krispy Kreme management report on Internal Control over Financial Reporting with excerpts from a Costco Wholesale Corporation management report on internal control over financial reporting, which identified a material weakness in its system of internal control. The material weakness related to information technology general controls which serves to reinforce the importance of information technology controls in today’s audit environment. The report was issued on October 26, 2018.

CHAPTER 6: Employee Fraud and the Audit of Cash

- Updated the discussion on bank cash confirmations to include a detailed description of the process and an example of electronic confirmation using Confirmation (formerly Confirmation.com).
- Added multiple new and current Auditing Insights focusing on recent interesting frauds involving the misuse of cash within an organization, including an insightful and somewhat humorous story involving lunch ladies at a school cafeteria.
- Revised the end-of-chapter content to address electronic bank confirmations.

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CHAPTER 7: Revenue and Collection Cycle

- Included a new section with details surrounding the audit of revenue recognized in accordance with ASC 606. The section discusses the five-step revenue recognition process and how auditors approach the issues involved.
- Included a new introduction to the chapter that discusses the recent Carillion fraud and the issues involved with estimation of revenue under longer-term revenue contracts.
- Added a comprehensive end-of-chapter exercise involving a substantive analytical procedure for auditing ticket revenue for a university. The exercise requires students to consider issues related to sufficiency of evidence and precision of data.
- Updated PCAOB inspection findings through the latest inspection reports.
- Included several new data and analytics exercises in the new Module G related to revenue recognition, along with several existing author-created and IDEA workbook exercises, enabling instructors to have many options for integration of data analytics into their courses.

CHAPTER 8: Acquisition and Expenditure Cycle

- Substantially revised all tables in the chapter to be identical in format for all cycle chapters (6-10). This enables instructors to present a common format that matches the current method of auditing, from identification of significant accounts and relevant assertions to substantive procedures to audit residual risks.
- Added multiple new auditing insights covering current news related to auditing the expenditure cycle.
- The end of chapter materials contain a new CPA Exam-style simulation that requires students to link audit issues to assertions, control procedures, and substantive procedures to match the new increase emphasis of these areas on the CPA Exam.

CHAPTER 9: Production Cycle and the Audit of Inventory

- Revised the chapter to focus on the audit of the inventory account, no longer primarily focusing on the production cycle. The chapter addresses risks of material misstatement in the inventory account for companies ranging from manufacturers to retailers such as Target.
- Substantially revised all tables in the chapter to be identical in format for all cycle chapters (6–10). This

enables instructors to present a common format that matches the current method of auditing, from identification of significant accounts and relevant assertions to substantive procedures to audit residual risks.

- End-of-chapter materials include a new CPA Exam-style simulation involving issues in an inventory count. An additional new end-of-chapter exercise involves fraud detection in an audit of inventory.
- New data and analytic exercises included with Module G focus on issues related to audits of the inventory account. The chapter continues to include a focus on data and analytics that integrates several IDEA exercises, including author-created content and end-of-chapter materials.
- Updated PCAOB inspection findings to focus on current issues being addressed in inspection reports.

CHAPTER 10: Finance and Investment Cycle

- Significantly expanded the discussion of auditing accounting estimates, including fair values, to address the newly revised PCAOB standards. In addition, added a much more detailed discussion of the general approach to auditing accounting estimates.
- Updated tables throughout the chapter to include examples involving auditing accounting estimates in investment accounts.
- Included in the introduction a new discussion of the very recent (August 2019) accusations against GE by Harry Markopolos. The introduction allows students to consider the difficult issues involved in auditing the finance and investment cycle and how the auditor may have approached these issues.

CHAPTER 11: Completing the Audit

- Updated discussion of Ability to Continue as a Going Concern for updates to *PCAOB Auditing*

Standard 2415 and *AICPA AU-C 570*, The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern.

- Updated introductory vignette to reflect current state of Valeant (now Bausch Health).
- Abbreviated Attorney Letter and Written Representations sections to include most relevant material.
- Replaced and updated Audit Insights and examples throughout the chapter to reflect more recent events.

CHAPTER 12: Reports on Audited Financial Statements

- Revised chapter and end-of-chapter materials to incorporate the revised auditors' report for non-issuers required by *Statement on Auditing Standards No. 134*.
- Added Auditing Insight relating to recent issues regarding the use of component auditors (U.K. affiliate firms' involvement in the audits of Amazon, BlackRock, and Citigroup; KPMG, Deloitte, and BDO's use of Zimbabwe affiliate firms; and Deloitte's use of multiple component auditors in the audit of Monsanto).
- Added examples from auditors' reports issued for Alphabet, Caesars Entertainment Corporation, DowDupont, Fannie Mae, Freddie Mac, General Electric, General Motors, Kraft Heinz Company, Tesla Inc., and YUM! Brands.
- Added appendix related to auditors' reports on financial statements and reports on internal control over financial reporting for issuers, including information relating to the topics included as critical audit matters in the early round of auditors' reports.
- Provided supplemental auditors' reports and end-of-chapter materials in Connect for instructors wishing more extensive coverage of auditors' reporting for issuers and the PCAOB audit report.

Part III: Stand-Alone Modules

MODULE A: Other Public Accounting Services

- Significantly streamlined and reorganized presentation into four major sections addressing special issues in GAAS audits, other attestation engagements, accounting and review service engagements, and assurance engagements.
- Expanded coverage of audits of financial statements prepared using a special purpose framework (based on recent guidance provided by *Statement on Auditing Standards No. 139*) and prospective financial information.

- Added Auditing Insights relating to the required scope of agreed-upon-procedures engagements required by the National Collegiate Athletics Association, PCAOB sanctions relating to broker-dealer compliance, deficiencies from a PCAOB inspection report related to the use of service auditor's reports, trends in corporate responsibility reporting, and BDO's assurance on Amazon Trust Services' Certification Authority operations.

- Incorporated tables and other pedagogical summaries throughout module to provide overview of key differences in scope of engagements and accountants' reports across different types of engagements.
- Significantly expanded end-of-chapter materials, including a number of Connect-gradable assignments.

MODULE B: Professional Ethics

- Added an Auditing Insight to illustrate the Generalization argument featuring the data breach at Equifax, the largest data breach in history. The breach resulted in the names, addresses, and social security numbers of over 147 million Americans being stolen. The data breach occurred in May 2017 but wasn't discovered by Equifax until July 29th, nearly two months later. It took the company another six weeks to notify the public that names and Social Security numbers of millions had been stolen. In the aftermath, the SEC brought charges against former Equifax Chief Information Officer Jun Ying in March of 2018 for using his knowledge of the breach to sell shares of the company's stock before the breach was made public.
- Added two new key terms, *independence in fact* and *independence in appearance*. Article IV of the AICPA's Professional Code of Conduct requires that "a member in public practice should be independent in fact and appearance when providing auditing and other attestation services." As a result, it was important to feature these concepts as key terms.
- Added an Auditing Insight that describes how PricewaterhouseCoopers (PwC) lost Alteryx as an audit client over independence concerns. Alteryx is a software product that was being used by PwC. As a result of their promotion of the software to their clients, executives at Alteryx became concerned about the independence of their auditing firm. As such, they replaced PwC with Deloitte.

MODULE C: Legal Liability

- Added a new introductory vignette on litigation involving PwC for its audits of Colonial Bank and resulting settlement with the FDIC.
- Updated the summary of major settlements involving Big Four accounting firms to include more recent settlements.
- 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.

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- Replaced and updated Audit Insights and examples throughout the module to reflect more recent events.

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

- New introductory vignette highlighting 2018 Atlanta cyber attack and the importance of the internal audit role and recommendations.
- Restructured learning objectives to include only three similar objectives focused on each of the three areas highlighted in the module, Internal Audits, Governmental Audits, and Fraud Examinations.
- Reorganized discussions of Internal Audits and Governmental Audits. Aligned the discussions to include similar topic headings including definition, types of services, standards, and reports.
- Consolidated review checkpoints to appear at the end of each of the three major sections; added three new review checkpoints for Internal Audits.
- Replaced and updated Audit Insights and examples throughout the module to reflect more recent events.

MODULES E and F: Sampling

- Focused sampling modules on applications of attributes (Module E) and variables (Module F) sampling, while integrating CPA-exam specific concepts and terminology from the former overview module as appropriate.
- Reoriented Modules E and F to illustrate how results from an attributes sampling application influence the necessary level of detection risk and variables sampling application.
- Included vignette in Module E to illustrate how polls in the 2017 United Kingdom "snap" election, 2016 Brexit vote, and 2016 United States presidential election were subject to sampling risk and emphasize the importance of controlling sampling risk in the audit examination.
- Included IDEA screen captures within modules to illustrate the identification and input of parameters as well as the evaluation of sample results.
- Expanded number of Connect-gradable assignments in end-of-chapter materials.

MODULE G: Data and Analytics in Auditing

- A **new** module addresses the key questions students have about what **Data and Analytics** are in an auditing context, and how audit procedures using these techniques should be conducted. The module follows the approach from the **AICPA Guide to Data Analytics in Auditing**.

- The module contains an extended discussion of information produced by the entity (IPE) and how the auditor should assess the completeness and accuracy of this information, as well as the precision of the information for the purposes of the auditing procedure.
- The end-of-chapter multiple choice, exercises and problems contain entirely author-created questions and examples, as well as significant assistance for instructors for implementing the exercises in their classrooms.
- Exercises and problems are linked to learning objectives in other chapters in the book to enable instructors to appropriately integrate the important topic of data and analytics throughout the auditing curriculum.

MODULE H: Auditing and Information Technology

- Given that the use of information technology (IT) is pervasive in the financial reporting process on largely all audit clients in today's environment, auditors must gain an understanding of how IT is used in the internal control system. This is now explained in detail in Module H with a focus on three phases: (1) determining the scope of the IT testing plan by carefully identifying each of the IT dependencies; (2) understanding the IT controls and processes that need to be tested for each IT dependency; and (3) testing the IT controls.
- In today's audit environment, to help facilitate the identification of IT dependencies, as key internal control activities are identified and understood by auditors, they are generally categorized as being: (1) purely manual control activities; (2) manual control activities that rely on a system generated report; or (3) entirely automated controls. Each of these categories is now described in detail in Module H.
- We increased our coverage of a commonly used form of reperformance testing referred to as the *test data approach*. When using this approach, the auditor will create a set of data to simulate a series of transactions that contain known errors in order to test whether the client's IT control activity is operating effectively. In the revised module, we included a commonly used example known as the *test of one* where auditors test a three-way match control in either the revenue or the purchasing process.



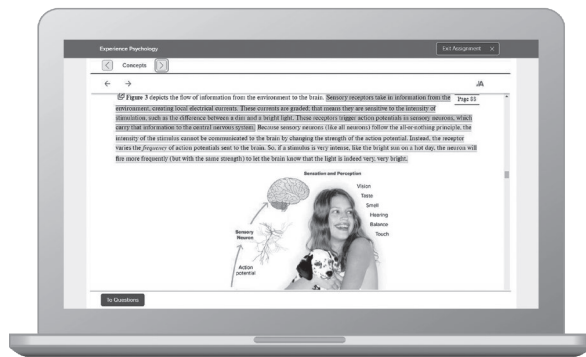
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Marie Blouin
Penn State University–Harrisburg

David Blum
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Russell F. Briner
University of Texas at San Antonio

Alexander K. Buchholz
*Brooklyn College of the City University
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California State University–East Bay

Eric Carlsen
Kean University

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