

TENTH EDITION

# AUDITING AND ASSURANCE SERVICES

*An Integrated Approach*

ALVIN A. ARENS | RANDAL J. ELDER | MARK S. BEASLEY



Tenth Edition

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# AUDITING AND ASSURANCE SERVICES

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An Integrated Approach

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# PREFACE

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## OBJECTIVE

*Auditing and Assurance Services: An Integrated Approach* is an introduction to auditing and other assurance services for students who have not had significant experience in providing such services. It is intended for either a one-quarter or one-semester course at the undergraduate or graduate level. This book is also appropriate for introductory professional development courses for CPA firms, internal auditors, and government auditors.

The primary emphasis in this text is on the auditor's decision-making process. We believe that the most fundamental concepts in auditing relate to determining the nature and amount of evidence the auditor should accumulate after considering the unique circumstances of each engagement. If a student of auditing understands the objectives to be accomplished in a given audit area, the circumstances of the engagement, and the decisions to be made, he or she should be able to determine the appropriate evidence to gather and how to evaluate the evidence obtained.

Thus, as the title of this book reflects, our purpose is to integrate the most important concepts of auditing and other assurance services as well as certain practical aspects in a logical manner to assist students in understanding audit decision making and evidence accumulation. For example, internal control is integrated into each of the chapters dealing with a particular functional area and is related to tests of controls and substantive tests of transactions; tests of controls and substantive tests of transactions are, in turn, related to the tests of details of financial statement balances for the area; and audit sampling is applied to the accumulation of audit evidence rather than treated as a separate topic. Technology, e-commerce, and fraud issues are integrated throughout the chapters.

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## MOST IMPORTANT CHANGES IN THE TENTH EDITION

A new chapter on fraud auditing provides expanded coverage of the auditor's responsibility for assessing the risk of fraud and detecting material misstatements due to fraud based on the fraud triangle in SAS 99. The chapter includes coverage of corporate governance and other factors that reduce fraud risk. Specific fraud risk areas and procedures to detect fraud are also discussed. Most other text chapters include new vignettes highlighting specific examples of fraud.

The requirements of the Sarbanes–Oxley Act and implementing rules adopted by the PCAOB and SEC are integrated throughout the text. The effects of the Act on the accounting profession are discussed in Chapter 2, and revised SEC independence requirements are described in Chapter 4 on professional ethics. Chapter 3 on audit reports includes an example of reporting on internal control required for public companies by the Sarbanes–Oxley Act, and evidence requirements for reporting on internal control are included in Chapter 10 on internal control. Additional requirements of the Act are incorporated throughout the text.

The annual report for the Hillsburg Hardware Company is included as a four-color insert to the text. Financial statements and other information included in the annual report are used in examples throughout the text to illustrate chapter concepts.

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**Chapter 11 on Fraud Auditing and Expanded Fraud Coverage**

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**Coverage of Sarbanes–Oxley Act and Related PCAOB and SEC Rules**

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**Hillsburg Hardware Annual Report**



The Pinnacle Manufacturing integrated case has been modified to represent a larger, multi-division company, and expanded from four to six parts. Each part of the case is included at the end of the chapter to which that part relates. The parts of the case are connected so that students will gain a better understanding of how the parts of the audit are interrelated and integrated by the audit process.

All chapters include an Internet-based case/homework assignment that requires students to use the Internet to research relevant auditing issues. New and updated Internet-based margin links appear in every chapter, providing information on current events, companies, and professional standards.

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## ORGANIZATION

The text is divided into six parts.

**Part 1, The Auditing Profession (Chapters 1–5)** This book begins with the demand for auditing and a study of the demand for audit and other assurance services. Chapter 1 emphasizes new assurance services being offered by CPA firms such as *WebTrust* and *CPA ElderCare Services*. Chapter 2 covers the CPA profession including organization of CPA firms, the AICPA, PCAOB, and the SEC. In Chapter 3, there is a detailed discussion of audit reports. It emphasizes the conditions affecting the type of report the auditor must issue and the type of audit report applicable to each condition under varying levels of materiality. Chapter 4 explains ethical dilemmas, professional ethics, independence, and the AICPA *Code of Professional Conduct*. Chapter 5 ends this part with an investigation of auditors' legal liability.

**Part 2, The Audit Process (Chapters 6–13)** The first two of these chapters deal with auditors' and managements' responsibilities, audit objectives, general concepts of evidence accumulation, and audit documentation. Chapter 8 deals with planning the engagement and using analytical procedures as an audit tool. Chapter 9 introduces materiality and risk and shows their effect on the audit. The study of internal control and assessment of control risk are discussed in Chapter 10, which emphasizes a proper methodology for obtaining an understanding of the five components of internal control. Chapter 11 is a new chapter on fraud auditing that describes the auditor's responsibility for assessing fraud risk and detecting fraud. The chapter also includes specific examples of fraud and discusses warning signs and procedures to detect fraud. Chapter 12 addresses the most important effects of information technology on internal controls in businesses, risks the auditor must consider, and audit evidence changes. Chapter 13 summarizes Chapters 6 through 12 and integrates them with the remainder of the text.

**Part 3, Application of the Audit Process to the Sales and Collection Cycle (Chapters 14–17)** These chapters apply the concepts from Part 2 to the audit of sales, cash receipts, and the related income statement and balance sheet accounts. The appropriate audit procedures for accounts in the sales and collection cycle are related to internal control and audit objectives for tests of controls, substantive tests of transactions, and tests of details of balances. Students learn to apply audit sampling to the audit of sales, cash receipts, and accounts receivable.

In response to an increased emphasis on nonstatistical sampling by practitioners, Chapters 15 and 17 emphasize nonstatistical sampling rather than statistical methods. Chapter 15 begins with a general discussion of audit sampling for tests of controls and substantive tests of transactions. Similarly, Chapter 17 begins with general sampling concepts for tests of details of balances. The next topic in each chapter is extensive coverage of nonstatistical sampling. The last part of each chapter covers statistical sampling techniques.

**Part 4, Application of the Audit Process to Other Cycles (Chapters 18–23)** Each of these chapters deals with a specific transaction cycle or part of a transaction cycle in much the same manner as Chapters 14 through 17 cover the sales and collection cycle. Each

chapter in Part IV is meant to demonstrate the relationship of internal controls, tests of controls, and substantive tests of transactions for each broad category of transactions to the related balance sheet and income statement accounts. Cash in the bank is studied late in the text to demonstrate how the audit of cash balances is related to most other audit areas.

**Part 5, Completing the Audit (Chapter 24)** This part includes only one chapter, which deals with summarizing all audit tests, reviewing audit documentation, and all other aspects of completing an audit.

**Part 6, Other Assurance and Nonassurance Services (Chapters 25 and 26)** The last two chapters deal with various types of engagements and reports, other than the audit of financial statements using generally accepted accounting principles. Topics covered include *WebTrust*, *SysTrust*, other assurance services, review and compilation services, agreed-upon procedures engagements, attestation engagements, other audit engagements, internal financial auditing, governmental financial auditing, and operational auditing.

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## SUPPLEMENTS

**NEW! Instructor's Resource CD-ROM** The **Instructor CD** contains print and technology (e.g., spreadsheets, videos) supplements on a single CD-ROM. Enjoy the freedom to transport the entire package from office, to home, to classroom. The CD-ROM enables you to customize any of the ancillaries, print only the chapters or materials you wish to use, or access any item from the package within the classroom!

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### Supplements for the Instructor

**NEW! Electronic Art Log** The **Electronic Art Log** contains every table, graph, and piece of art from the book. Enjoy the freedom to create your own PowerPoint presentations or overhead transparencies. Available online at [www.prenhall.com](http://www.prenhall.com) and on the Instructor's Resource CD-ROM.

**Instructor's Manual** Suggestions for each chapter include: Homework problems, how learning objectives correlate with chapter problem material, and transparency masters. Chapters have been designed so that their arrangement and selection provides maximum flexibility in course design. Sample syllabi and suggested term projects are provided. The Instructor's Manual is also available to adopters on the Instructor's Resource CD-ROM and online at [www.prenhall.com](http://www.prenhall.com).

**Solutions Manual** Included are detailed solutions to all the end-of-chapter exercises, problems, and cases. Guidelines for replies to review questions and discussion questions are offered. The Solutions Manual is also available to adopters on the Instructor's Resource CD-ROM and online at [www.prenhall.com](http://www.prenhall.com).

**Test Item File & TestGen** The printed **Test Item File** includes multiple choice exercises, true/false, essay questions, and questions related to the chapter vignettes. To assist the instructor in selecting questions for use in examinations and quizzes, each question has been assigned one of three difficulty ratings—easy, medium, or challenging. Formatted for easy copying, **TestGen** testing software is an easy-to-use computerized testing program. It can create exams, evaluate, and track student results.

**PowerPoint Slides** PowerPoint presentations are available for each chapter of the text. Instructors have the flexibility to add slides and/or modify the existing slides to meet the courses' needs. The PowerPoint Slides are also available to adopters on the Instructor's Resource CD-ROM and online at [www.prenhall.com](http://www.prenhall.com).

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**Enhanced Companion Web Site** Prentice Hall's Learning on the Internet Partnership offers the most expansive Internet-based support available. Our Web site provides a wealth of resources for students and faculty. Resources include:

- Twice a year, faculty will be able to access newsletter **summaries of the most recent changes to professional standards** and summaries of major issues affecting the auditing profession. This will help instructors to stay informed of emerging issues.
- **“Internet Margin Links,”** included in each chapter, encourage students to use the Internet to learn more about issues, services, or organizations covered in the text.
- **“Internet Problems,”** end-of-chapter assignments available for most chapters, require students to utilize the Internet to conduct research in order to develop a solution.
- **“Faculty Web Links”** provided for most chapters take interested instructors to related Internet sites.

**Free Online “Study Guide”** Students receive immediate feedback on tests, including total score, an explanation provided for each incorrect answer, and the ability to e-mail the results to a faculty member. All questions are created specifically for the Study Guide and there is no duplication of questions taken from the text or test bank.

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**The Lakeside Company: Case Studies in Auditing, 9th ed., by Hoyle/Trussel** This practice set guides the student through the life cycle of an audit from beginning to end. The cases are designed to create a realistic view of how an auditor organizes and carries out an audit.

**Cases from the SEC Files: Topics in Auditing by Cullinan/Wright** Wright and Cullinan have compiled a collection of the best SEC cases. Now you have two choices: 1) Select this paperback collection of cases or 2) create your own custom version of cases from [www.prenhall.com](http://www.prenhall.com). Best of all? The collection of online SEC cases will continue to evolve so that your collection will always contain the most current cases that reflect SEC actions!

**Auditing Cases, 2nd ed., Buckless/Beasley/Glover/Prawitt** This collection of 36 auditing cases addresses most major activities performed during the conduct of an audit, from client acceptance to issuance of an audit report. Several cases ask students to work with realistic audit evidence to prepare and evaluate audit schedules. The cases are available as a collection or as part of the Pearson Custom Publishing Resources Program. For details, go to: [www.prenhall.com](http://www.prenhall.com).

We acknowledge the American Institute of Certified Public Accountants for permission to quote extensively from statements on auditing standards, the *Code of Professional Conduct*, Financial Accounting Standards Board, Uniform CPA Examinations, and other publications. The willingness of this major accounting organization to permit the use of its materials is a significant contribution to the book.

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A. A. A.  
R. J. E.  
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