



# Principles of Auditing

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# **Principles of Auditing**

**The Robert N. Anthony/Willard J. Graham Series in Accounting**



# Preface



## **THE REASONS FOR A “REVISED” EIGHTH EDITION**

We in the public accounting profession are accustomed to changes—changes in the business environment, new legislation, new auditing standards, and new challenges. But never have we seen such sweeping changes in our authoritative literature as those occurring in late 1987 and early 1988. Within the span of a few months, the American Institute of Certified Public Accountants (AICPA) adopted a new code of professional ethics, changed the content of the auditors’ standard report, and made numerous changes in our professional standards. These pronouncements had a major effect on the technical content of five chapters in our original eighth edition, and a lesser effect on many other chapters. In response, we are publishing this special “revised eighth edition” which integrates these new pronouncements.

Our goal is for students to understand the philosophy and environment of auditing. Thus, our first 11 chapters provide a sweeping overview of auditing, with special attention to the nature and economic purpose of audits, auditing standards, professional ethics, auditors’ legal liability, the study and evaluation of internal control, and the nature of audit evidence. In addition to this conceptual approach, this edition, as did the preceding ones, presents auditing techniques in an organized and understandable manner. In our final chapter, we discuss professional services other than audits that may be undertaken by the auditing staff of a CPA firm. These

services include compilations, reviews, reports on internal accounting control, and operational audits.

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**NEW FEATURES  
OF THE EIGHTH  
EDITION**

The revised eighth edition includes all of the new learning and instructional aids that made the original eighth edition such an effective textbook. Among the many new features of the eighth edition are:

**Research and Discussion Cases**, provocative case-study situations often based upon actual auditing dilemmas. These cases are designed to acquaint students with the process of researching auditing problems and to illustrate the inescapable need for exercising personal professional judgment. These cases, which are labeled as “Group IV” problem material, are provided for a majority of our chapters.

An increased number of **illustrations, tables, and flow charts**. These graphic displays have been designed to visually summarize key points. Also increased in number are the **Illustrative Cases**, using actual business examples to illustrate important concepts.

A **Study Guide**, written by the textbook authors and designed to enable students to review textbook material and to test their understanding. The guide includes a summary of the highlights of each chapter and an abundance of objective questions and exercises. Answers to the questions and exercises are included at the back of the guide to provide students with immediate feedback.

An **Instructors’ Guide** with topical outlines of each chapter, the authors’ personal comments on each chapter, and numerous instructional aids, such as transparency masters and topics to supplement classroom discussions. Also included in the Instructors’ Guide is an extensive test bank, including many original questions and problems as well as questions adapted from various professional examinations.

The chapter discussing the auditors’ reporting obligations has been moved from late in the textbook to the position of the second chapter. Our coverage of this all-important topic is up-to-date, based on the new format for the auditors’ report.

The chapter on the audit of electronic data processing systems has been expanded to include control and audit considerations relating to advanced computer systems and to minicomputers. Throughout the textbook, we have increased the emphasis on auditing in an EDP environment.

Our ethics chapter features the new **Professional Code of Conduct**. Emphasis is placed on the need for judgment in evaluating situations that might impair independence.

A virtually new chapter on auditors’ liability covers recent court decisions and clearly explains the auditors’ responsibilities under the federal securities acts.

A carefully revised and easy-to-understand chapter on audit sampling includes a new discussion of the risks inherent in the sampling process. Emphasis is placed on basic concepts of importance to every auditor,

rather than on statistical considerations of interest primarily to statistical specialists.

An extensively revised last chapter distinguishes between the responsibilities of an auditor and those of a CPA performing accounting and review services. Emphasis is placed on the responsibility assumed by the CPA in issuing special reports, reports on internal accounting control, and reports on compilations and reviews.

Both text discussion and problem material have been updated to reflect the latest pronouncements of the Auditing Standards Board, the SEC, and the FASB. This material is integrated into text and problem material to assure coverage of all topical areas included in recent CPA examinations. In addition, both the text and problem material have been expanded to include coverage of topics that are simply too controversial to be taken up by the professional standard-setting committees.

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**END-OF-CHAPTER  
PROBLEM  
MATERIAL**

The questions, problems, and case materials at the end of each chapter are divided as follows: Group I—Review Questions; Group II—Questions Requiring Analysis; Group III—Problems; and Group IV—Research and Discussion Cases.

The review questions are closely related to the material in the chapter and provide a convenient means of determining whether the student has grasped the major ideas and implications contained in that chapter.

The questions requiring analysis call for thoughtful appraisal of realistic auditing situations and the application of generally accepted auditing standards. Many of these Group II questions are taken from CPA examinations, others from actual audit engagements. These thought-provoking questions requiring analysis differ from the Group III problems in that they are generally shorter and tend to stress value judgments and conflicting opinions.

Many of the Group III problems have been drawn from CPA examinations; in the selection of these problems, consideration was given to all auditing problems which have appeared in CPA examinations in recent years. Other problems reflect actual audit situations from the experience of practicing accountants. Many of the problems are new, but problems appearing in the previous editions have been retained (usually with some modification) if they were superior to other available problems. In response to the recent shift in content of the auditing section of the CPA examination, problems requiring extensive working papers and quantitative applications have been minimized, and short case-type questions have been emphasized.

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**RESEARCH AND  
DISCUSSION  
CASES**

One of the new pedagogical features of this eighth edition is the inclusion of 10 Research and Discussion Cases in the end-of-chapter problem material. These cases involve controversial situations that do not lend themselves to clear-cut answers. Students are asked to research the ap-



appropriate auditing and accounting literature and then to formulate and justify their personal positions on the issue. The cases are designed to acquaint students with the professional literature, to develop research and communications skills, and to demonstrate that several diverse yet defensible positions may be argued persuasively in a given situation. Research and Discussion Cases appear as Group IV problem material at the ends of Chapters 2, 3, 4, 5, 6, 8, 10, 12, 14, and 19.

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**REFERENCES TO  
AUTHORITATIVE  
SOURCES**

Numerous references are made to the pronouncements of the Auditing Standards Board, the American Institute of Certified Public Accountants, the Financial Accounting Standards Board, and the Securities and Exchange Commission. Special attention is given to the *Professional Code of Conduct* and to *Statements on Auditing Standards*. The cooperation of the AICPA in permitting the use of its published materials and of questions from the Uniform CPA Examination brings to an auditing text an element of authority not otherwise available.

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**CONTRIBUTIONS  
BY OTHERS**

We want to express our sincere thanks to the many users of the preceding editions who offered helpful suggestions for this edition. Especially helpful were the advice and suggestions of the following reviewers: H. David Brecht, California State University, Sacramento; Larry D. Gardner, Northern Arizona University; Wai P. Lam, University of Windsor; Earl Monical, University of Wisconsin; Robert A. Provost, Bryant College; Ronald O. Reed, University of Colorado; and Frank F. Weinberg, Golden Gate University.

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