

AUDITING

A RISK ANALYSIS APPROACH



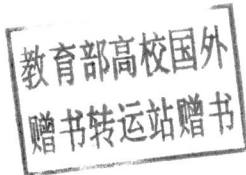
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LARRY F. KONRATH

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AUDITING: A RISK ANALYSIS APPROACH

5th Edition



LARRY F. KONRATH
University of Toledo



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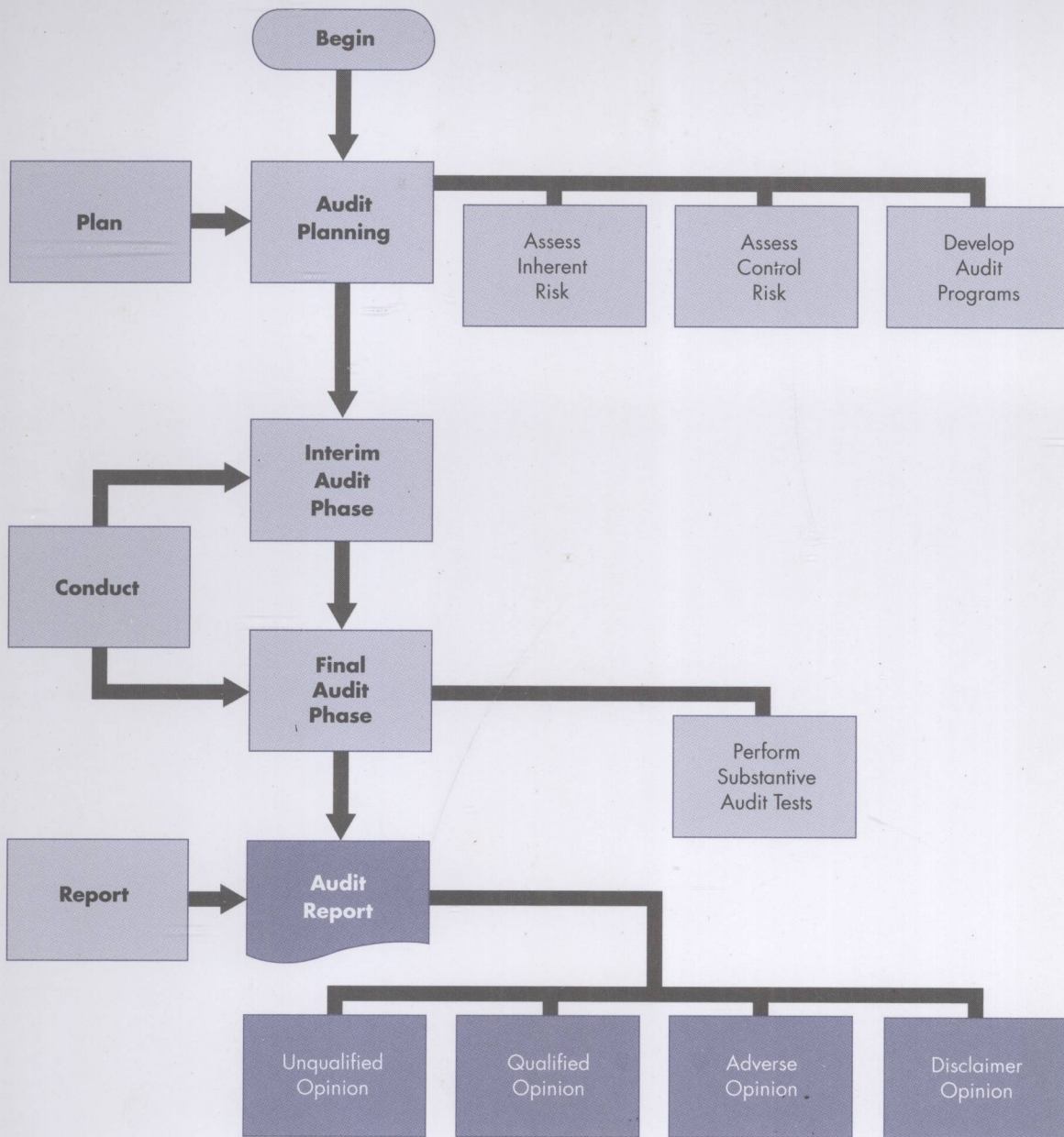
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THE AUDIT PROCESS



OBJECTIVES AND APPROACH

Like its earlier editions, the fifth edition of *Auditing: A Risk Analysis Approach* stresses the important elements of risk-based auditing. In meeting this goal, the text offers an in-depth framework that addresses the concepts of audit evidence and materiality. Emphasis is given to the meeting of user expectations through audit risk analysis, application of audit judgment, and ethical considerations in auditing.

The fifth edition also addresses the broader aspects of assurance services that have gained increasing emphasis in contemporary auditing. Today's CPA applies a concept of assurance that is much broader than traditional financial statement auditing, performing such attest services as evaluating performance measurement systems, assessing the reliability of information systems, appraising an entity's business risk assessment function, and rating the integrity of electronic commerce.

The text strikes a balance between conceptual and applied aspects of auditing. In this regard, *Auditing: A Risk Analysis Approach* provides students with an effective preparation source for the auditing part of the Certified Public Accountants examination and is well documented with materials from pronouncements by the American Institute of Certified Public Accountants (AICPA).

To stress the importance of risk-based auditing, audit risk is introduced in Chapter 1, after which two entire chapters are devoted to audit risk (Chapters 5 and 7). After the topic is developed in Chapters 5 and 7, the concept of risk analysis and its relationship to the audit program is explored quantitatively in two chapters on statistical sampling (Chapters 9 and 10). The coverage of statistical sampling in auditing is extensive and affords the student the opportunity to visualize clearly the relationship between various levels of audit risk and their impact on the nature, timing, and extent of audit procedures.

To offer full coverage of audit risk, the text assigns much of the accounting systems details to useful chapter appendices. Since many senior-level accounting students have had a course in accounting information systems (AIS), assignment of systems details to appendices reduces unnecessary topic redundancy in the systems and the auditing courses. For those who have not had a prior systems course, the appendix following Chapter 7 should provide sufficient background information.

Changes in Fifth Edition

The fifth edition of *Auditing: A Risk Analysis Approach* retains and builds upon the framework developed in earlier editions. Major changes from the fourth edition include the following:

- The text is now divided into five distinct parts to promote continuity and structure:
 1. The Auditing Profession—Chapters 1–3
 2. Planning the Audit—Chapters 4–8
 3. Conducting the Audit—Chapters 9–13
 4. Reporting the Results of the Audit—Chapter 14
 5. Other Attestation and Assurance Services—Chapters 15–16
- Chapter 15 devotes greater attention to other assurance services, such as WebTrust, SysTrust, and ElderCare.

- The fifth edition offers several Internet assignments directing students to web sites such as the AICPA, the Independence Standards Board, the Public Register's Annual Report Service, the Australian Education Research Pty. Ltd., and 10K Wizard (an EDGAR database search engine).
- The fifth edition also provides numerous references to web sites as added sources of information.
- The *Bilrite Computer Audit Practice Case* has been revised to enable students to begin the case earlier in the course. This has been achieved by dividing the former Module I into two parts:

Module I: Inherent Risk Analysis—to be completed following Chapter 5; and

Module II: Control Risk Analysis—to be completed following Chapter 8.

In addition, as part of analytical procedures, students are directed to the web site of Cannondale, an actual bicycle manufacturer, and are asked to compare key percentages and ratios with Bilrite.

- New essay questions and discussion cases involving actual companies are presented. Examples are Waste Management, Rite Aid, IBM, W.R. Grace, Bankers Trust, Sunbeam Corp., California Micro Devices, McKesson HBOC Inc., and Cendant Corp.
- The text has expanded coverage related to auditor independence, including greater attention to the work of the Independence Standards Board and the Panel on Audit Effectiveness. The SEC's concern about independence and management consulting is also discussed at some length.
- Increased attention is given to the topic of ethics and the concept of ethical behavior is discussed generally, followed by a more CPA-specific discussion of the Code of Professional Conduct
- Chapter 8, Internal Control and Computer-Based Information Systems, has been updated to reflect new audit approaches and techniques given changes in technology and the computer environment.
- The web site for *Auditing: A Risk Analysis Approach* (<http://konrath.swcollege.com>) has been upgraded and expanded. Online tutorials, PowerPoint presentation slides, links to web sites referred to in the text, and auditing terminology crossword puzzles are new, additional learning reinforcements.

Learning Aids and Pedagogical Tools

Computer Audit Practice Case

The appendix following Chapter 16 contains a computer audit practice case, Bilrite Bicycles, Inc. The practice case is divided into fifteen modules that parallel related chapter topics. A CD containing partially completed audit workpapers in Excel is included with the textbook. The modules, which may be assigned individually or severally at the instructor's option, begin following Chapter 5. They continue at the end of succeeding chapters, ending with Chapter 14.

The practice case permits the student to discover how much of the typical financial audit can be automated with the computer. In addition, the student obtains hands-on exposure to computer auditing. The modules are sufficiently condensed that excessive amounts of computer time are not consumed. However, at the same time, the student must assess audit risk, analyze data, apply auditing procedures, and evaluate the results—all with the aid of the computer. These materials make *Auditing: A Risk Analysis Approach* unique in the auditing textbook market and add an exciting dimension to the study of auditing.

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Audit Workpaper Templates

Excel templates contained on the Biltrite CD included with this textbook accompany six author-prepared essay/discussion case questions. The templates consist of partially completed audit workpapers. Students are asked to complete the workpapers by analyzing data, performing calculations, stating conclusions, and using audit legends to describe procedures applied. These mini cases give students the opportunity to simulate the audit field work experience and to learn how the computer assists in performing and documenting audits.

The cases, identified in the end-of-chapter materials by the Biltrite CD icon, are as follows:



Chapter 4: Discussion Case—Hanlon, Inc.

Chapter 5: Discussion Case IV—Marcus Publishing, Inc.

Chapter 11: Problem 11.10—Colorado Processing, Inc.

Chapter 12: Problem 12.12—Selfers Service Center

Chapter 13: Problem 13.15—Marvel Muffler Shops, Inc.

Chapter 13: Problem 13.16—Branson Manufacturing Company

Audit Objectives and Procedures Matrices

Matrices providing an integrated framework for analysis are included in appendices following Chapters 11 through 13.

The matrix approach helps to reinforce students' understanding of substantive audit testing by providing a framework for developing audit programs. This approach also enables students to build their own audit programs around careful risk analysis and formulation of specific objectives.

Use of Cases

To bring the material alive and to emphasize the importance of risk analysis in auditing, *Auditing: A Risk Analysis Approach* makes liberal use of case examples. Extensive references to cases involving auditors serves to reinforce students' mastery of concepts by relating a given concept to an actual company. Some of the cases are incorporated into the chapters, while others are included as end-of-chapter materials. All of the cases are based on actual events and are structured to contrast what should have been done with what actually was done.

Illustrations

Extensive use is made of diagrams, tables, and listings to ease the learning process. Internal control flowcharts and listings of necessary documents, records, and functions appended to the control chapters provide an easy review of control techniques without unnecessarily cluttering the chapter on internal control concepts.

Coverage of AICPA Professional Standards

The standards issued by the American Institute of Certified Public Accountants, referred to as AICPA Professional Standards, are given comprehensive coverage throughout the text as they impact given subject areas.

Chapter Organization

Careful attention has been given in the fifth edition to chapter organization in order to maintain maximum clarity and completeness. The study of auditing is organized into five major categories. Chapters 1 through 3 describe the auditing profession; Chapters 4 through 8 present a conceptual approach to planning the audit; Chapters 9 through 13 discuss the process of conducting the audit; Chapter 14 describes audit reports; and Chapters 15 and 16 consider other attestation and assurance services.

Chapter Overview and Learning Objectives

At the beginning of each chapter, an overview and a list of learning objectives are presented to introduce the reader to the major topics to be covered and to identify the major concepts to be learned from studying the chapter.

Key Terms and Glossary

A list of key terms is provided at the end of each chapter and serves as additional reinforcement of the learning process. Although auditing is related to accounting, it is not the same. The auditing student encounters many new terms, as well as familiar terms with a different connotation.

A glossary at the end of the textbook supplements the list of key terms and helps the student learn the language of auditing.

End-of-Chapter Materials

Essay questions, problems, and discussion cases, along with multiple choice questions from past CPA and CIA exams, are supplied at the end of each chapter. End-of-chapter review questions and applicable parts of the Biltrite computer audit practice case also are included. Flowcharting problems following Chapters 7 and 8 afford an opportunity to study an internal control narrative and graphically present it in the form of a flowchart. The template problems, together with the Biltrite practice case, offer a “hands-on” audit field work experience.

When considered collectively, these materials serve the dual purpose of solidifying the learning process and providing the student with questions important to CPA exam preparation. The multiple choice questions are especially effective in reviewing the contents of the Statements on Auditing Standards (SASs), a major component of the auditing part of the CPA exam. Answers to the multiple choice questions, along with the reasons for correct and incorrect choices, are given at the end of the textbook.

Supplements

Materials available to supplement this textbook include an *Instructor's Manual/Solutions Manual*, *Examview Testing Software* (a computerized Test Bank), and an *Instructor's Resource CD* (IRCD). The Test Bank is also available in printed form and, in addition to multiple choice questions from past CPA and CIA examinations, contains author-prepared multiple choice, completion, matching, and essay questions.

The *Instructor's Manual* includes the following:

1. Answers to end-of-chapter materials: review questions, multiple choice questions, essay questions, problems (including the six template problems referred to earlier),

discussion cases, and Internet assignments. For CPA exam and CIA exam questions, the official answers are supplied. For multiple choice questions, narratives supporting correct choices and reasons other choices are incorrect accompany the answers.

2. Useful outlines for preparing lectures on the topics presented in each chapter.
3. Printout of solutions to the Bilrite Bicycles audit practice case modules.
4. Transparency masters highlighting important chapter topics.
5. Teaching suggestions at the beginning of each chapter, as appropriate, and for the Bilrite Bicycles audit practice case.

The *Instructor's Resource CD* contains:

1. The Instructor's Manual
2. The Solutions Manual
3. The Test Bank—Examview Testing Software
4. Completed workpapers for the Bilrite Bicycles audit practice case
5. Completed templates for the six case/problem assignments for which partial templates are provided on the student diskette.
6. PowerPoint presentation slides
7. Transparency Masters

Web site Resources include: <http://konrath.swcollege.com>

Instructor Resources:

- Lecture outlines from the *Instructor's Manual*
- Solutions to essay questions, problems, and discussion cases
- Solutions to the Bilrite Bicycle case modules
- Internet activities solutions
- Teaching suggestions
- PowerPoint presentation slides
- PowerPoint transparency masters

Student Resources:

- Online tutorials
- PowerPoint slides
- Case spreadsheets in Excel
- Internet activities
- Links to web sites referenced in the text
- Auditing terminology crossword puzzles and solutions by chapter

In addition, the web site contains a link to the current Cannondale Corporation Annual Report and Form 10-K. Cannondale is introduced in an early Bilrite Case module for comparison purposes.

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The author would like to thank the American Institute of Certified Public Accountants and the Institute of Internal Auditors for their generosity in granting permission to quote extensively from the professional literature, as well as for their permission to use past professional examination questions as a major part of the end-of-chapter materials.

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