



SEVENTH EDITION

# AUDITING

An Integrated Approach

ARENS • LOEBBECKE

# AUDITING

## An Integrated Approach

Seventh Edition

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# PREFACE

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## OBJECTIVES

The seventh edition of *Auditing: An Integrated Approach* contains numerous changes and revisions, but the objectives and emphasis remain essentially the same.

The book is an introduction to auditing for students who have not had significant experience in auditing. It is intended for either a one-quarter or one-semester course at the undergraduate or graduate level. The 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 the book reflects, our purpose is to integrate the most important concepts of auditing 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.

To enhance students' understanding of the auditor's decision-making process, a new feature of the seventh edition is the addition of vignettes to each chapter. Each chapter begins with an opening vignette that describes a realistic scenario similar to one that students might encounter in audit practice. In addition, several vignettes appear throughout the chapters to provide students with practice examples, supplemental information, and technology updates related to chapter material.

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## ORGANIZATION

The text is divided into six parts.

**Part 1, The Auditing Profession (Chapters 1–4)** The book begins with a description of the nature of auditing and auditing firms, the AICPA, and the SEC. In Chapter 2, 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 3 explains ethical dilemmas, professional ethics, and the AICPA *Code of Professional Conduct*. Chapter 4 ends this part with an investigation of auditors' legal liability.

**Part 2, The Auditing Process (Chapters 5–10)** The first two of these chapters deal with auditors' and managements' responsibilities, audit objectives, and general concepts of evidence accumulation. In addition, Chapter 6 emphasizes analytical procedures as an audit tool.

Chapter 7 deals with planning the engagement and the preparation of audit working papers. Chapter 8 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 9, which emphasizes a proper methodology for obtaining an understanding of the five components of internal control. Chapter 10 summarizes Chapters 5 through 9 and integrates them with the remainder of the text.

**Part 3, Application of the Auditing Process to the Sales and Collection Cycle (Chapters 11–14)**

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 various instructors' comments, we have reorganized Chapters 12 and 14 on audit sampling. Each chapter now begins with a general discussion of audit sampling for tests of controls and substantive tests of transactions (Chapter 12) and tests of details of balances (Chapter 14). The next topic covered in each chapter is nonstatistical sampling. This topic has been expanded significantly in the seventh edition in response to instructors' requests. The last part of each chapter covers statistical sampling techniques.

**Part 4, Auditing Complex EDP Systems (Chapter 15)** This chapter covers understanding internal control and assessing control risk for more complex EDP systems, the audit of systems that include significant EDP applications, and auditing with or without the use of the computer. The emphasis in this chapter is on the effect of a more complex EDP system on the way an audit is conducted.

**Part 5, Application of the Auditing Process to Other Cycles (Chapters 16–21)** Each of these chapters deals with a specific transaction cycle or part of a transaction cycle in much the same manner as Chapters 11 through 14 deal with the sales and collection cycle. Each chapter in Part 5 is meant to demonstrate the relationship of internal control, 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 6, Completing the Audit and Offering Other Services (Chapters 22–24)** This set of chapters begins with summarizing all audit tests, reviewing working papers and other aspects of completing the audit. The remaining 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 review and compilation services, other audit engagements, attestation engagements, agreed-upon procedures engagements, internal financial auditing, governmental financial auditing, and operational auditing.

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## SUPPLEMENTS

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### Service for the Instructor

**The Prentice Hall Accounting and Taxation Hotline 1-800-227-1816** Prentice Hall's unique Accounting and Taxation Hotline is your direct link to satisfying all your adoption needs! By calling our toll-free telephone number, you can receive information on Prentice Hall's Accounting and Tax texts and supplements. The Hotline will also process your orders and keep you up-to-date on the upcoming Prentice Hall Accounting Seminars for Educators (PHASE) in your area.



**Instructor's Resource Manual** This integrated source assists the instructor in teaching the course. The features include Teaching Transparencies instructions for assignments, as well as helpful suggestions provided by the text authors on how to effectively teach each chapter. To enhance and simplify course planning, chapter Learning Objectives are integrated throughout the problem material. Identified in the problem material are **spreadsheet template related problems**. Refer to xix of the Instructions Resource Manual for alternative uses.

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**Several Supplements are Available for Faculty and/or Students' Use**

**Solutions Manual** This comprehensive resource provides detailed solutions to all the end-of-chapter review questions, multiple choice questions, problems, and cases.

**Test Item File—prepared by David Kerr of Texas A&M University** Completely revised for this edition, the Test Item File contains approximately 3,000 test items including true/false, multiple-choice, exercises/problems, critical thinking/essay, fill-in-the-blanks, short answer, questions adapted from CPA exams, and questions on the new chapter opening vignettes. Each test item in this effective testing tool includes a difficulty level and has been content-reviewed for clarity and checked for accuracy.

**Prentice Hall Custom Test, by Engineering Software Associates (ESA), Inc.** Available on both DOS and Windows, this easy-to-use computerized testing program is available on 3.5" diskettes. This user-friendly program allows you to create an exam, as well as evaluate and track student results. The PH Custom Test also provides on-line testing capabilities. Test material is adapted from the Test Item File.

**A Database of PowerPoint Slides—prepared by Douglas S. Beets, Wake Forest University** A variety of PowerPoint slides are available for each chapter of the text. This computerized supplement provides the instructor with an interactive presentation that outlines the chapter material and reinforces text concepts using colorful graphics and charts. Instructors have the flexibility to customize the existing slides to meet their courses' needs.

**Study Guide—prepared by Dennis L. Kimmell of Akron University** For each text chapter, the Study Guide discusses the chapter objectives and summarizes its content. In addition, each chapter contains true/false, completion statements, and multiple-choice questions to reinforce text concepts and help students prepare for examinations. CPA and CIA examination questions are also provided.

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**Supplements for the Student**

**Career Paths in Accounting—CD-ROM** Winner of the New Media INVISION Gold Award in Education, this CD-ROM provides students with a dynamic, interactive job-searching tool. Included are workshops in career planning, resume writing, and interviewing skills. Students can learn the latest market trends and facts as well as the skills required to get the right job. In addition, the CD-ROM provides the student with salary information, video clips describing specific jobs, and profiles of practitioners in the field.

**The Audit: Its Environment and Application—by Gregory C. Yost** This hands-on text is designed to stimulate elements of the actual audit process, the accounting profession, the public accounting firm, and the client. Used as a stand alone or as a supplement to a traditional text, this text requires students to identify and resolve issues associated with the auditing practice. An Instructor's Guide is also available.

**The Lakeside Company: Case Studies in the Life-Cycle of an Audit prepared by John Trussel, Hood College, and Joe Ben Hoyle, University of Richmond** An efficient and effective Practice Set that 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. An Instructor's Solutions Manual is also available.

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## ACKNOWLEDGMENTS

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A.A.A.  
J.K.L.

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