

 Seventh Edition



# Auditing

AN INTERNATIONAL APPROACH

SMIELIAUSKAS    BEWLEY



# Auditing

AN INTERNATIONAL APPROACH

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**Auditing: An International Approach  
Seventh Edition**

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*Wally Smieliauskas dedicates this book to  
Reid and Lucas.*

*Kathryn Bewley dedicates this book to all the auditing students,  
educators, and practitioners who work so hard to keep auditing essential.*

# About the Authors

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At the University of Toronto, Professor Smieliauskas developed the first degree-credit introductory auditing course (in 1981) and the first advanced auditing course (in 1990). In 1988 he was the first director of the MBA Co-op Program in Professional Accounting, a position he held until 1993. The program is designed to facilitate the entry of undergraduates from various fields into the profession and to provide a broader management education as well as specialized training in accounting, auditing, and tax topics. It has evolved to become the Master of Management & Professional Accounting (MMPA) program now offered through the University of Toronto's Mississauga campus.

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# PREFACE TO THE SEVENTH EDITION

This seventh edition incorporates the many professional developments that have taken place since the sixth edition (2013). We continue our approach of providing in-depth coverage of fundamental auditing concepts and techniques in the context of current developments affecting the audit profession and practice in Canada and internationally. These developments include the roll-out of the new audit report expected to go into effect December 15, 2016; a new emphasis on ethical reporting; a continuing emphasis on risk-based auditing, auditor independence, and engagement quality standards; and the further maturation of public accountability boards and their monitoring activities.

Since the sixth edition, the auditing profession in Canada has been transformed by the merger of the three previous accounting bodies, CMA, CGA, and CA, into one new association now called CPA Canada (Chartered Professional Accountants of Canada), with parallel changes taking place at the provincial level. This merger is accompanied by changes to the education and certification requirements for professional accountants (PAs) and auditors. Also, the authoritative material previously published by the CICA (Canadian Institute of Chartered Accountants) is now published by CPA Canada. This seventh edition reflects these changes to the extent they have been implemented or finalized up to the time of writing.

Starting in 2011, financial reporting in Canada has been greatly altered by the introduction of two separate sets of Canadian generally accepted accounting principles (GAAP): International Financial Reporting Standards (IFRS) for public companies and Accounting Standards for Private Enterprises (ASPE). The implications of these changes on financial statement audits are reflected in this edition. One important implication is the expanding use of fair value accounting estimates. Further, the increasing complexity and speed of change in business and the economy have greatly increased the need to make many kinds of estimates in financial statements. These changes are placing greater focus on the considerable uncertainty embedded in such accounting numbers, as illustrated in the continuing financial crises that have rippled through the global economy since 2008. This seventh edition provides new, unique coverage of the auditing and assurance issues related to the new audit report, and use of estimates in financial statements, important areas for research and development in current audit practice. The implications for this on risk assessment, evidence gathering, and forming an audit opinion on fair presentation are key challenges we have presented in our discussions of the audit process. Fraud, corporate governance, ethical reporting, independence risk, the role of audit committees, global convergence of audit and accounting standards, and information technology (IT) remain highly relevant to the auditing profession, and information on all of these issues has been updated for the seventh edition.

This edition reflects these developments through early 2015, offering our perspective on their significance. In this current audit environment, we see not only radical changes in audit standards and the regulatory environment but also significantly revised expectations of the auditor's role in corporate governance and capital markets. This environment is characterized by more risks for auditors and their clients than ever before, as well as more restrictions on non-audit services for audit clients. We hope our coverage of these challenging new developments will help students appreciate the dynamic nature of the audit function in our economy, bring up to date the role of auditing in the current financial reporting environment, and provide opportunities to develop the critical thinking skills needed for the next generation of auditors.

## WHAT'S NEW IN THE SEVENTH EDITION?

This seventh edition has been developed to make the learning experience enjoyable and straightforward for students, while still fostering essential critical thinking skills that challenge students as they learn. Key updates and ongoing approaches are as follows:

- An Essentials section has been added at the beginning of each chapter to summarize the most important concepts.
- Multiple-choice questions have been added to all chapters.
- Chapter material has been reorganized to facilitate the study of auditing in those universities, colleges, and programs that offer one audit course as well as those that offer two or more audit courses. Introductory material on professional ethics and liability is presented in Part 1, with more in-depth coverage later in Part 4. The coverage of risk and control has been reorganized to cover understanding and assessment of risks in Chapter 6, and then internal controls over financial reporting, risk of material misstatement, and fraud risk in Chapter 7. We are confident this approach will provide students and instructors with more choice in how they engage with the material. The organization of the seventh edition is elaborated on in the section below, where we describe the coverage provided in each of the 4 parts and 21 chapters.
- The innovative introduction of critical thinking concepts that integrate ethical, accounting, and auditing theory to help structure professional audit decision making and analysis in financial reporting has been supplemented by the revised Appendix 3A on the ethics and natural-language reasoning that underlie auditor judgments and the justifications of decisions documented in audit work.
- A streamlined overview of the audit process has been added to Chapter 5, serving as a road map to the procedural topics covered in the text.
- References to specifics of the Canadian Auditing Standards (CASs), based on International Standards on Auditing (ISAs), have been retained in the “Standards Check” boxes located at key points of the discussion as a quick link to the specific paragraphs of the CAS that are relevant to applying the concepts. These are an efficient way to introduce students to how they can use the standards as a resource for understanding and implementing generally accepted auditing standards (GAAS) in practice. *CPA Canada Assurance Handbook* changes through mid-2015 have been incorporated.
- Several new exhibits and tables have been added to summarize concepts and techniques and to help students understand and apply key auditing practices.
- The chapter on auditing accounting estimates (Chapter 19, available on Connect) has been enhanced with an accounting analytics case study. This chapter explains the concepts of CAS 540 and builds on the accounting risk concept introduced in earlier editions, as a way of helping implement critical thinking in audited financial reporting.
- Updated online appendices on the more technical aspects of statistical sampling in auditing, corporate governance, IT, internal control, and critical thinking are provided to help integrate auditing, accounting, and ethical reasoning.
- Various updated anecdotes, asides, short cases, and Application Cases with suggested solutions and analysis in each chapter enrich the text material.
- Several new critical thinking and Internet assignment questions complement the preceding changes, and a number of new cases, including some from the professional accounting exams, have been added.
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- **Standards Checks.** Excerpts from the CASs are provided to enrich the discussion of key concepts by demonstrating how the standards require them to be applied by auditors in practice.
- **Professional Standards References.** Each chapter references the relevant professional standards for the chapter topics.
- **Anecdotes and Asides.** Illustrative anecdotes and asides are found throughout the text and have been updated considerably in this new edition. Some are located within the chapter text, while others stand alone (in boxes) to add realism and interest for students. A continuing fictional case is provided for the EcoPak company, with an episode of the case appearing at the start of each chapter. In each episode, many of the concepts and issues to be presented in the chapter arise in a realistic audit setting. The result is a real-world flavour of the treatment of auditing.
- **Exhibits.** To assist in the learning process, we have included several more exhibits in this edition to visually illustrate teaching concepts.
- **Icons for Critical Thinking, Fraud/Ethics, International Standards, and Internet Assignments.** For quick and easy identification purposes, we have included these icons to flag the text material dealing with these major issues.



## Application Cases with Solution & Analysis

Most chapters include an Application Case with Solution & Analysis illustrating the application of concepts introduced in the chapter. The purpose of the Application Cases is to enliven the study of auditing by introducing the professional judgments involved in the practice of auditing. They supplement the exposition of auditing fundamentals with illustrative situations based on real events. The Application Cases in the chapters of Parts 2 and 3 follow the experiences of a new auditor joining a firm of PAs. Many of the Application Cases deal with what might be considered advanced material by many. Nevertheless, they can serve as a useful basis for class discussion. The solutions provided are not the only ones possible; consequently, they provide an opportunity to develop the critical perspectives that are an important element of professional judgment in auditing.

## Key Terms

Throughout the text, key terms are highlighted in boldface print, with definitions conveniently located at the bottom of the page containing the bolded term. Understanding these terms is crucial to success in auditing. An alphabetical glossary is also provided at the end of the text.

## ORGANIZATION

### Part I: Introduction to Auditing, Public Practice, and Professional Responsibilities

Part 1 consists of four chapters covering the basic orientation to auditing as a profession. Chapter 1 introduces the concept of auditing and the role of the public accounting profession. Chapter 2 introduces GAAS, assurance standards, and quality control standards, providing an overview of the audit process. Chapter 3 introduces professional ethics and professional legal responsibilities, including a technical appendix on critical thinking incorporating the auditor's social role and social expectations. Chapter 4 covers audit reports with emphasis on the new audit report to go into effect at the end of 2016.

### Part 2: Basic Auditing Concepts and Techniques

Part 2 is organized to present financial statement audit planning from a business risk perspective. Chapter 5 introduces the most basic concepts of an independent financial statement audit engagement, including the acceptance decision, the auditor's need to understand an auditee's business and its risks, preliminary analytical procedures, and materiality. Chapter 6 explains how auditors' understanding of the business, its environment, and its risks is used to assess the risk that the financial statements are materially misstated. It explains the key concept of financial statement assertions, and the business processes and the related accounting cycles that create the financial statements. Chapter 7 expands on the business understanding and risk assessment by providing an overview of information systems controls used by management to reduce risks of materially misstating this information. Chapter 7 also discusses the auditor's awareness of fraud risk; it explains the nature and signs of fraud and the procedures used to detect it. Chapter 8 presents the fundamental concepts of audit evidence and the evidence-gathering procedures used to develop the detailed audit plan and programs, as well as describing working paper documentation. Chapter 9 elaborates on internal control consideration in an audit engagement, describing the auditor's procedures for evaluating the auditee's internal control, and control risk assessment and control testing in performing the audit.

The topics presented in Chapters 5 through 9 provide a basis for developing an appropriate overall strategy for the audit, the detailed audit plan, and specific programs used to perform the audit. Chapter 10 covers the pervasive concept of audit testing, the major categories of risk that arise in a sampling context and how these relate to audit risk, how testing is affected by the audit risk model, and how representative testing can be implemented using the most simple formulas and tables from statistical sampling. An extensive appendix to Chapter 10 (Appendix 10B, available on Connect) provides more details on the technical aspects of statistical sampling. Application Cases are used to provide practical perspectives on the planning issues covered in Part 2.

### Part 3: Performing the Audit

Part 3 contains four chapters that address performing the work set out in a detailed audit plan for the main business processes that will need to be managed in every organization, a fifth chapter that wraps it all up with audit completion considerations, and a sixth chapter that covers applying professional judgment. The processes covered are as follows: the Revenues, Receivables, and Receipts Process (Chapter 11); the Purchases, Payables, and Payments Process (Chapter 12); the Payroll and Production Processes (Chapter 13); and the Finance and Investment Process (Chapter 14). Each of these chapters provides an overview of the transactions, balances, and risks of misstatement in the business process, the relevant controls, and auditing procedures. Application Cases are used to illustrate the application of concepts and techniques in practice, and examples of audit programs are provided to demonstrate the kinds of audit procedures that can be used. Each of these chapters also provides an overview of the balance sheet approach as a basis for the overall analysis of the financial statements. Chapter 15 presents various activities involved in completing the audit work, such as the audit of the revenue and expense accounts, overall analytical review, lawyer's letters, management representation letters, and subsequent events. Chapter 16 provides an overview of issues to consider in the opinion formulation process, including accumulation of misstatements discovered in the audit, adjustments to the financial statements, and the auditor's formation of the opinion to be expressed in the audit report. This chapter includes a summary of the recently issued ISAs that will require expansion of the specific details auditors will report related to their audit opinions.

### Part 4: Advanced Issues in Professional Public Accounting Practice

The five chapters in Part 4 (all available on Connect) are designed to stand alone or be integrated piecemeal with the preceding chapters as part of a first course in auditing. However, there is enough material in Part 4 that, when combined with some of the earlier chapters and some readings, such as those indicated in the text, can be the basis for a second, advanced, audit course. Such a course could focus, for example, on auditor problems and judgments in evaluating the quality of financial reporting.

Chapter 17 deals with other assurance and some non-assurance services offered by public accounting firms. Chapter 18 covers the more detailed aspects of professional ethics. Chapter 19 is a new chapter devoted to the increasingly important topic of the audit of accounting estimates. The chapter has two parts. Part I clarifies the difficult concepts of CAS 540 using the idea of accounting risk that can be associated with the point estimate concept of CAS 540. Part II deals with the more complex issues of estimation uncertainty associated with reasonable ranges of CAS 540. Estimation uncertainty is analyzed and integrated with the IFRS conceptual framework for financial reporting with the help of the accounting risk concept. This integration guides auditor judgments with respect to appropriate financial reporting. New analytical tools in the form of accounting analytics using market information and Monte Carlo simulations to help verify accounting estimates have been added to the discussion. These tools help make operational critical thinking about the ethics of accounting estimates. Chapter 20 covers auditor legal liability issues in more detail, extending the coverage of this topic beyond the introductory level of Chapter 3. Finally, Chapter 21 covers the conceptual framework for assurance engagements and some specialized assurance engagements. The second half of Chapter 21 covers fraud awareness auditing in more detail. It gives students a better understanding of the mindset and specialized procedures needed to more effectively detect frauds. This chapter has benefited from our association with the Association of Certified Fraud Examiners (ACFE).

## PROFESSIONAL STANDARDS

This text contains numerous references to, and excerpts from, authoritative statements on auditing standards and to standards governing other areas of practice. Even so, it goes beyond the mere repetition of passages from the standards, concentrating on explaining their substance and operational meaning in the context of making auditing decisions. Instructors and students may wish to supplement the text with current editions of pronouncements published by the International Federation of Accountants (IFAC), CPA Canada, and the Institute of Internal Auditors.

## MARKET-LEADING TECHNOLOGY



### Learn without Limits

McGraw-Hill Connect® is an award-winning digital teaching and learning platform that gives students the means to better connect with their coursework, with their instructors, and with the important concepts that they will need to know for success now and in the future. With Connect, instructors can take advantage of McGraw-Hill's trusted content to seamlessly deliver assignments, quizzes, and tests online. McGraw-Hill Connect is the only learning platform that continuously adapts to each student, delivering precisely what they need, when they need it, so class time is more engaging and effective. Connect makes teaching and learning personal, easy, and proven.

### Connect Key Features

**SmartBook®** As the first and only adaptive reading experience, SmartBook is changing the way students read and learn. SmartBook creates a personalized reading experience by highlighting the most important concepts a student needs to learn at that moment in time. As a student engages with SmartBook, the reading experience continuously adapts by highlighting content based on what each student knows and doesn't know. This ensures that he or she is focused on the content needed to close specific knowledge gaps, while it simultaneously promotes long-term learning.

**Connect Insight®** Connect Insight is Connect's new one-of-a-kind visual analytics dashboard—now available for both instructors and students—that provides at-a-glance information regarding student performance, which is immediately actionable. By presenting assignment, assessment, and topical performance results together with a time metric that is easily visible for aggregate or individual results, Connect Insight gives the user the ability to take a just-in-time approach to teaching and learning, which was never before available. Connect Insight presents data that empower students and help instructors improve class performance efficiently and effectively.

**Simple Assignment Management** With Connect, creating assignments is easier than ever, so instructors can spend more time teaching and less time managing. Instructors can

- Assign SmartBook learning modules
- Edit existing questions and create their own questions
- Draw from a variety of text-specific questions, resources, and test bank material to assign online
- Streamline lesson planning, student progress reporting, and assignment grading to make classroom management more efficient than ever

**Smart Grading** When it comes to studying, time is precious. Connect helps students learn more efficiently by providing feedback and practice material when they need it, where they need it. Instructors can

- Automatically score assignments, giving students immediate feedback on their work and comparisons with correct answers
- Access and review each response; manually change grades or leave comments for students to review
- Track individual student performance—by question or assignment or in relation to the class overall—with detailed grade reports
- Reinforce classroom concepts with practice tests and instant quizzes
- Integrate grade reports easily with Learning Management Systems including Blackboard, D2L, and Moodle

**Instructor Library** The Connect Instructor Library is a repository for additional resources to improve student engagement in and out of the class. It provides all the critical resources instructors need to build their course. Instructors can

- Access instructor resources
- View assignments and resources created for past sections
- Post their own resources for students to use

## Instructor Resources

The instructor area of Connect includes a variety of resources for faculty:

- *Instructor's Solutions Manual*. The solutions manual, created by the authors, provides the answers to problem and assignment material that is featured throughout the text.
- *Computerized Test Bank*. The computerized test bank contains numerous multiple-choice, short-answer, and essay questions.
- *Microsoft® PowerPoint® Lecture Slides*. The PowerPoint slides offer a summary of chapter concepts for lecture purposes.
- *Image Library*

## Superior Learning Solutions and Support

The McGraw-Hill Education team is ready to help you assess and integrate any of our products, technology, and services into your course for optimal teaching and learning performance. Whether it's helping your students improve their grades, or putting your entire course online, the McGraw-Hill Education team is here to help you do it. Contact your Learning Solutions Consultant today to learn how to maximize all of the resources!

For more information on the latest technology and Learning Solutions offered by McGraw-Hill Education and its partners, please visit us online: <http://www.mheducation.ca/highereducation/educators/digital-solutions/>.

## ACKNOWLEDGMENTS

IFAC and CPA Canada have generously given permission for liberal quotations from official pronouncements and other publications, all of which lend authoritative sources to the text. In addition, several publishing houses, professional associations, and accounting firms have granted permission to quote and extract from their copyrighted material. Their cooperation is much appreciated because a great amount of significant auditing thought exists in this wide variety of sources.

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This text could not have been completed without the cooperation and input of our many auditing students who have shared their perspectives with us over the years. We thank them greatly for their contributions and for encouraging us to make the text ever clearer.

And, lastly, our sincere thanks go out to the reviewers of this seventh edition for their careful review and many detailed and candid comments. We are deeply grateful to all the reviewers who have so diligently read our early chapter drafts and taken so much time to share their experience and wonderful, inspiring examples of how they teach auditing concepts. In each edition, we try to incorporate as many of these excellent ideas and suggestions as our publication page constraints allow:

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Alla Volodina, *York University*

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# PREFACE TO THE SEVENTH EDITION

This seventh edition incorporates the many professional developments that have taken place since the sixth edition (2013). We continue our approach of providing in-depth coverage of fundamental auditing concepts and techniques in the context of current developments affecting the audit profession and practice in Canada and internationally. These developments include the roll-out of the new audit report expected to go into effect December 15, 2016; a new emphasis on ethical reporting; a continuing emphasis on risk-based auditing, auditor independence, and engagement quality standards; and the further maturation of public accountability boards and their monitoring activities.

Since the sixth edition, the auditing profession in Canada has been transformed by the merger of the three previous accounting bodies, CMA, CGA, and CA, into one new association now called CPA Canada (Chartered Professional Accountants of Canada), with parallel changes taking place at the provincial level. This merger is accompanied by changes to the education and certification requirements for professional accountants (PAs) and auditors. Also, the authoritative material previously published by the CICA (Canadian Institute of Chartered Accountants) is now published by CPA Canada. This seventh edition reflects these changes to the extent they have been implemented or finalized up to the time of writing.

Starting in 2011, financial reporting in Canada has been greatly altered by the introduction of two separate sets of Canadian generally accepted accounting principles (GAAP): International Financial Reporting Standards (IFRS) for public companies and Accounting Standards for Private Enterprises (ASPE). The implications of these changes on financial statement audits are reflected in this edition. One important implication is the expanding use of fair value accounting estimates. Further, the increasing complexity and speed of change in business and the economy have greatly increased the need to make many kinds of estimates in financial statements. These changes are placing greater focus on the considerable uncertainty embedded in such accounting numbers, as illustrated in the continuing financial crises that have rippled through the global economy since 2008. This seventh edition provides new, unique coverage of the auditing and assurance issues related to the new audit report, and use of estimates in financial statements, important areas for research and development in current audit practice. The implications for this on risk assessment, evidence gathering, and forming an audit opinion on fair presentation are key challenges we have presented in our discussions of the audit process. Fraud, corporate governance, ethical reporting, independence risk, the role of audit committees, global convergence of audit and accounting standards, and information technology (IT) remain highly relevant to the auditing profession, and information on all of these issues has been updated for the seventh edition.

This edition reflects these developments through early 2015, offering our perspective on their significance. In this current audit environment, we see not only radical changes in audit standards and the regulatory environment but also significantly revised expectations of the auditor's role in corporate governance and capital markets. This environment is characterized by more risks for auditors and their clients than ever before, as well as more restrictions on non-audit services for audit clients. We hope our coverage of these challenging new developments will help students appreciate the dynamic nature of the audit function in our economy, bring up to date the role of auditing in the current financial reporting environment, and provide opportunities to develop the critical thinking skills needed for the next generation of auditors.

## WHAT'S NEW IN THE SEVENTH EDITION?

This seventh edition has been developed to make the learning experience enjoyable and straightforward for students, while still fostering essential critical thinking skills that challenge students as they learn. Key updates and ongoing approaches are as follows:



- An Essentials section has been added at the beginning of each chapter to summarize the most important concepts.
- Multiple-choice questions have been added to all chapters.
- Chapter material has been reorganized to facilitate the study of auditing in those universities, colleges, and programs that offer one audit course as well as those that offer two or more audit courses. Introductory material on professional ethics and liability is presented in Part 1, with more in-depth coverage later in Part 4. The coverage of risk and control has been reorganized to cover understanding and assessment of risks in Chapter 6, and then internal controls over financial reporting, risk of material misstatement, and fraud risk in Chapter 7. We are confident this approach will provide students and instructors with more choice in how they engage with the material. The organization of the seventh edition is elaborated on in the section below, where we describe the coverage provided in each of the 4 parts and 21 chapters.
- The innovative introduction of critical thinking concepts that integrate ethical, accounting, and auditing theory to help structure professional audit decision making and analysis in financial reporting has been supplemented by the revised Appendix 3A on the ethics and natural-language reasoning that underlie auditor judgments and the justifications of decisions documented in audit work.
- A streamlined overview of the audit process has been added to Chapter 5, serving as a road map to the procedural topics covered in the text.
- References to specifics of the Canadian Auditing Standards (CASs), based on International Standards on Auditing (ISAs), have been retained in the “Standards Check” boxes located at key points of the discussion as a quick link to the specific paragraphs of the CAS that are relevant to applying the concepts. These are an efficient way to introduce students to how they can use the standards as a resource for understanding and implementing generally accepted auditing standards (GAAS) in practice. *CPA Canada Assurance Handbook* changes through mid-2015 have been incorporated.
- Several new exhibits and tables have been added to summarize concepts and techniques and to help students understand and apply key auditing practices.
- The chapter on auditing accounting estimates (Chapter 19, available on Connect) has been enhanced with an accounting analytics case study. This chapter explains the concepts of CAS 540 and builds on the accounting risk concept introduced in earlier editions, as a way of helping implement critical thinking in audited financial reporting.
- Updated online appendices on the more technical aspects of statistical sampling in auditing, corporate governance, IT, internal control, and critical thinking are provided to help integrate auditing, accounting, and ethical reasoning.
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- **Standards Checks.** Excerpts from the CASs are provided to enrich the discussion of key concepts by demonstrating how the standards require them to be applied by auditors in practice.
- **Professional Standards References.** Each chapter references the relevant professional standards for the chapter topics.
- **Anecdotes and Asides.** Illustrative anecdotes and asides are found throughout the text and have been updated considerably in this new edition. Some are located within the chapter text, while others stand alone (in boxes) to add realism and interest for students. A continuing fictional case is provided for the EcoPak company, with an episode of the case appearing at the start of each chapter. In each episode, many of the concepts and issues to be presented in the chapter arise in a realistic audit setting. The result is a real-world flavour of the treatment of auditing.
- **Exhibits.** To assist in the learning process, we have included several more exhibits in this edition to visually illustrate teaching concepts.
- **Icons for Critical Thinking, Fraud/Ethics, International Standards, and Internet Assignments.** For quick and easy identification purposes, we have included these icons to flag the text material dealing with these major issues.

## Application Cases with Solution & Analysis

Most chapters include an Application Case with Solution & Analysis illustrating the application of concepts introduced in the chapter. The purpose of the Application Cases is to enliven the study of auditing by introducing the professional judgments involved in the practice of auditing. They supplement the exposition of auditing fundamentals with illustrative situations based on real events. The Application Cases in the chapters of Parts 2 and 3 follow the experiences of a new auditor joining a firm of PAs. Many of the Application Cases deal with what might be considered advanced material by many. Nevertheless, they can serve as a useful basis for class discussion. The solutions provided are not the only ones possible; consequently, they provide an opportunity to develop the critical perspectives that are an important element of professional judgment in auditing.

## Key Terms

Throughout the text, key terms are highlighted in boldface print, with definitions conveniently located at the bottom of the page containing the bolded term. Understanding these terms is crucial to success in auditing. An alphabetical glossary is also provided at the end of the text.

## ORGANIZATION

### Part I: Introduction to Auditing, Public Practice, and Professional Responsibilities

Part 1 consists of four chapters covering the basic orientation to auditing as a profession. Chapter 1 introduces the concept of auditing and the role of the public accounting profession. Chapter 2 introduces GAAS, assurance standards, and quality control standards, providing an overview of the audit process. Chapter 3 introduces professional ethics and professional legal responsibilities, including a technical appendix on critical thinking incorporating the auditor's social role and social expectations. Chapter 4 covers audit reports with emphasis on the new audit report to go into effect at the end of 2016.

### Part 2: Basic Auditing Concepts and Techniques

Part 2 is organized to present financial statement audit planning from a business risk perspective. Chapter 5 introduces the most basic concepts of an independent financial statement audit engagement, including the acceptance decision, the auditor's need to understand an auditee's business and its risks, preliminary analytical procedures, and materiality. Chapter 6 explains how auditors' understanding of the business, its environment, and its risks is used to assess the risk that the financial statements are materially misstated. It explains the key concept of financial statement assertions, and the business processes and the related accounting cycles that create the financial statements. Chapter 7 expands on the business understanding and risk assessment by providing an overview of information systems controls used by management to reduce risks of materially misstating this information. Chapter 7 also discusses the auditor's awareness of fraud risk; it explains the nature and signs of fraud and the procedures used to detect it. Chapter 8 presents the fundamental concepts of audit evidence and the evidence-gathering procedures used to develop the detailed audit plan and programs, as well as describing working paper documentation. Chapter 9 elaborates on internal control consideration in an audit engagement, describing the auditor's procedures for evaluating the auditee's internal control, and control risk assessment and control testing in performing the audit.

The topics presented in Chapters 5 through 9 provide a basis for developing an appropriate overall strategy for the audit, the detailed audit plan, and specific programs used to perform the audit. Chapter 10 covers the pervasive concept of audit testing, the major categories of risk that arise in a sampling context and how these relate to audit risk, how testing is affected by the audit risk model, and how representative testing can be implemented using the most simple formulas and tables from statistical sampling. An extensive appendix to Chapter 10 (Appendix 10B, available on Connect) provides more details on the technical aspects of statistical sampling. Application Cases are used to provide practical perspectives on the planning issues covered in Part 2.