

# PRINCIPLES OF AUDITING

& OTHER ASSURANCE SERVICES



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**AICPA Codification of Auditing Standards (AU Codification Section → Primary SAS)**

**AU Section\***

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\* The AICPA is currently involved in recodifying the standards and eliminating redundant coverage due to the passage of SAS Nos. 104-111. Accordingly, various AU Sections will be modified or eliminated.

✓ Section scheduled to be eliminated in new recodification (see \* above).

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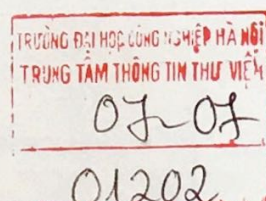
52	Omnibus SAS—1987	Various
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113	Omnibus SAS—2006	Various
114	The Auditor's Communication With Those Charged With Governance	380

\*The AICPA is currently involved in recodifying the standards and eliminating redundant coverage due to the passage of SAS Nos. 104-111. Portions of various SASs will be superseded. Also, as indicated below, certain SASs will be entirely superseded.

✓ SAS scheduled to be superseded in new recodification (see \* above).



# Principles of Auditing & Other Assurance Services



# Principles of Auditing & Other Assurance Services

Sixteenth Edition

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# Preface

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Recent years have seen unprecedented changes in the auditing profession. These changes were initiated by the revelation that management of many large public companies, including Enron and WorldCom, had systematically misstated company financial statements. In incident after incident, an audit report with an independent public accounting firm's clean opinion accompanied the misstated financial statements. As a result, we have witnessed congressional hearings about the accounting profession, the criminal conviction (later overturned) of the international accounting firm of Arthur Andersen LLC, the passage of the Sarbanes-Oxley Act of 2002, and the creation of the Public Company Accounting Oversight Board, which takes from the profession the major portion of its self-regulating authority. Most recently the AICPA Auditing Standards Board passed a set of eight Statements on Auditing Standards (SASs) referred to as "risk assessment standards." Designed to enhance audit effectiveness, these risk assessment standards modify the overall approach to a financial statement audit and align it with standards now followed by the major accounting firms and with international auditing standards.

Our goal in this edition has been to provide students with a clear perspective of today's auditing environment. We do this by presenting:

1. **A balanced presentation.** This text provides a carefully balanced presentation of auditing and assurance theory and practice. The concepts are written in a clear, concise, and understandable manner suitable for students who have not had significant audit experience. Real company examples are integrated throughout the text to bring this material to life. Finally, Keystone Computers & Networks, Inc., the text's illustrative audit case, is integrated into selected chapters, providing students with hands-on audit experience.
2. **Clarification of the changes affecting the profession and the profession's standards.** The authors have integrated coverage of the most important new and revised legal and auditing standards affecting the auditing profession to provide students with the most up-to-date auditing text available. Particularly emphasized are the profession's new risk assessment standards.
3. **CPA examination support.** This text includes both multiple choice questions and simulations aimed at helping students pass the new computerized CPA exam.
4. **Strong support materials.** The Online Learning Center provides instructors and students with a wealth of material to help keep students up-to-date. The Center also contains quizzes and other resources to help students in this course. The address of the Center (and the text Web site) is [www.mhhe.com/whittington16e](http://www.mhhe.com/whittington16e).

We are confident that the 16th edition of *Principles of Auditing & Other Assurance Services* will provide students with a clear perspective of today's new auditing environment.

O. Ray Whittington

Kurt Pany



# Key Features of the Book

**Sarbanes-Oxley Act of 2002** and the resulting **Public Company Accounting Oversight Board** profoundly affect public accountants, CPA firms, and their clients. Most notably, the public accounting profession is no longer largely self-regulating. CPAs now must issue a publicly available report on the internal control of each publicly traded client, and top management must certify the company's financial statements and provide an assessment of internal control over financial reporting. The text carefully integrates coverage of the act's nature and its effects on the profession in selected chapters. Also included is coverage of financial frauds, such as those involving Enron and WorldCom, which led to passage of the act.

The first 9 chapters of the text emphasize the philosophy and environment of the profession, with special attention paid to the nature and economic purpose of auditing and assurance services, professional standards, professional conduct, legal liability, audit evidence, audit planning, consideration of internal control, audit sampling, audit documentation, and general records.

**Chapter 2:** Includes the new wording and requirements of the 10 generally accepted auditing standards.

**Chapter 3:** Updated to reflect the most recent AICPA and PCAOB requirements.

**Chapter 4:** Clear, concise coverage of CPA legal liability based on suggestions by legal scholar Professor Marianne Jennings of Arizona State University.

**Chapters 5 through 7:** Material from *Statements on Auditing Standards Nos. 102–111*, the risk assessment standards, thoroughly integrated throughout.

**Chapter 5:** Includes new documentation requirements of *SAS 103*.

**Chapter 6:** The risk assessment approach to an audit is concisely summarized in a summary of the audit process.

**Chapter 7:** Updated to include a brief overview of audits of internal control over financial reporting required for public companies under PCAOB *Standard No. 5*, with more detailed coverage provided in Chapter 18. Also reflects *SAS 112* on auditor internal control communication responsibilities.

1. The Role of the Public Accountant in the American Economy
2. Professional Standards
3. Professional Ethics
4. Legal Liability of CPAs
5. Audit Evidence and Documentation
6. Audit Planning, Understanding the Client, Assessing Risks, and Responding
7. Internal Control
8. Consideration of Internal Control in an Information Technology Environment
9. Audit Sampling



**Keystone Computers & Networks, Inc.**, is the text's **Illustrative Audit Case**. This feature has been updated in this edition and illustrates audit methods and provides realistic, thought-provoking case exercises. Although each portion of the case is designed to stand alone, if used in combination, the case will help the student develop problem-solving skills in planning (Chapter 6), in considering internal control and testing account balances (Chapters 11 and 14), and in completing the audit (Chapter 16). The case incorporates the use of computerized accounting applications and also integrates the fundamentals of audit sampling from Chapter 9.

10. Cash and Financial Investments
11. Accounts Receivable, Notes Receivable,  
and Revenue
12. Inventories and Cost of Goods Sold
13. Property, Plant, and Equipment:  
Depreciation and Depletion
14. Accounts Payable and Other Liabilities
15. Debt and Equity Capital
16. Auditing Operations and  
Completing the Audit
17. Auditors' Reports
18. Integrated Audits of Public Companies
19. Additional Assurance Services: Historical  
Financial Information
20. Additional Assurance Services:  
Other Information
21. Internal, Operational, and Compliance Auditing

**International Auditing Standards** are discussed as appropriate. These standards are becoming increasingly significant with the development of international markets for securities.

**Chapters 10 through 16:** These "procedural chapters" deal with internal control and obtaining audit evidence about the various financial statement accounts; the chapters emphasize the risk-based approach to selecting appropriate audit procedures suggested by *SASs 102–111* and *SAS 99* on fraud and the expectation gap standards.

**Chapter 17:** Presents the auditors' reporting responsibilities for audits of financial statements for both public and nonpublic companies.

**Chapter 18:** Entirely updated to reflect PCAOB *Standard No. 5* on the audit of internal control over financial reporting required for public companies.

**Chapter 19:** Covers compilation and review engagements, as well as special reports.

**Chapter 20:** Discusses a variety of attestation and other assurance services. The material on attestation services describes the current professional standards. Other assurance services are included at both a conceptual and practical level.

**Chapter 21:** Includes a discussion of compliance auditing based on the suggestions of Mr. Norwood J. Jackson, former Deputy Controller, Office of Federal Management, U.S. Office of Management and Budget. It is updated for the 2007 revision to the "Yellow Book."