

19e

PRINCIPLES OF AUDITING & OTHER ASSURANCE SERVICES

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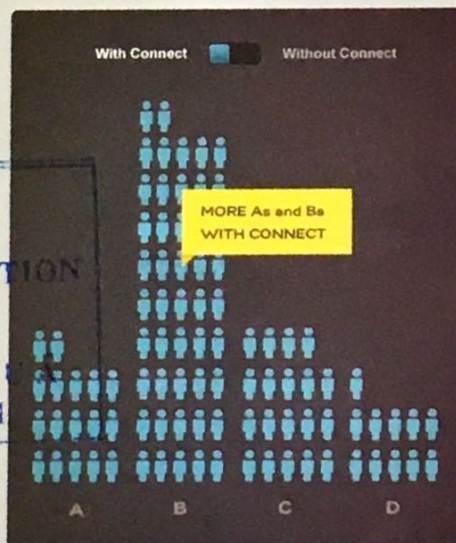
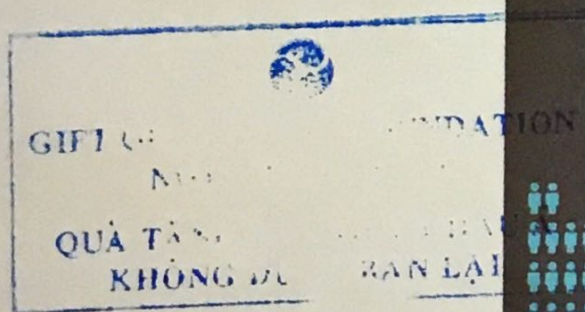
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Transforming Audit and Risk
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The integrated solutions for **Whittington/Pany's *Principles of Auditing & Other Assurance Services, 19e***, has been proven to help you achieve your course goals of student preparedness, relevancy, and mastery of concepts leading to critical application. The Whittington/Pany solution employs relevant examples from popular companies, and instant feedback on decision-oriented questions in order to achieve higher outcomes in the course.

In addition, the Interactive Applications deliver the learning objective in an engaging environment, which allows students to directly interact with the chapter content.



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FEATURES

Interactive Applications

The screenshot shows a web-based interface for a quiz. At the top, there's a header with 'today', a user icon, and links for 'instructions' and 'help'. Below this is a progress bar and a 'save & exit' button. The main content area is titled '1. 10.00 points' and includes a 'key term' button. The primary instruction reads: 'Understanding of relationships is of primary importance in understanding the auditor's Code of Professional Conduct regarding independence. Place the following relationships into the appropriate category.' Below this instruction is a table with two columns: 'Immediate Family' and 'Close Relative'. The table lists various relationships in two columns: Brother, Father, Dependent Parent, Roommate, Niece, Sister, Gift Partner, Spouse Equivalent (i.e., domestic partner), Mother, Spouse, Nephew, Independent (i.e., general) Child, Cousin, College Friend, Dependent Child, and Grandfather. At the bottom of the interface, there are navigation buttons: 'Previous', 'Click And Drag', 'Next', and 'Submit'. The footer contains the text '© 2010 Cengage Learning' and 'All rights reserved.'

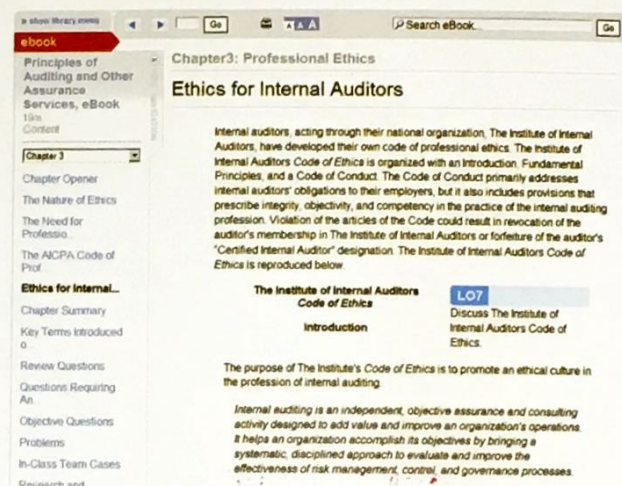
Immediate Family	Close Relative
Brother	Father
Dependent Parent	Roommate
Niece	Sister
Gift Partner	Spouse Equivalent (i.e., domestic partner)
Mother	Spouse
Nephew	Independent (i.e., general) Child
Cousin	College Friend
Dependent Child	Grandfather

Connect® Accounting's
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Principles of Auditing & Other Assurance Services

Nineteenth Edition



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**McGraw-Hill
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PRINCIPLES OF AUDITING & OTHER ASSURANCE SERVICES, NINETEENTH EDITION

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Preface

The 19th edition of *Principles of Auditing & Other Assurance Services* provides a carefully balanced presentation of auditing theory and practice. Written in a clear and understandable manner, it is particularly appropriate for students who have had limited or no audit experience. The approach is to integrate auditing material with that of previous accounting financial, managerial, and systems courses.

The text's first nine chapters emphasize the philosophy and environment of the auditing profession, with special attention paid to the nature and economic purpose of auditing, auditing standards, professional conduct, legal liability, audit evidence, audit planning, consideration of internal control, and audit sampling. Chapters 10 through 16 (the "procedural chapters") deal with internal control and obtaining evidence about the various financial statement accounts, emphasizing a risk-based approach to selecting appropriate auditing procedures. Chapter 17 presents the auditors' reporting responsibilities when performing financial statement audits. Chapter 18 provides detailed guidance on integrated audits of public companies performed in accordance with the Sarbanes-Oxley Act of 2002 and SEC requirements. Chapters 19 and 20 present the auditors' reporting responsibilities and other attestation and accounting services, such as reviews and compilations of financial statements and reports on prospective financial statements. Chapter 21 presents coverage of internal compliance and operational auditing.

The text is well suited for an introductory one-semester or one-quarter auditing course. Alternatively, it is appropriate for a two-course auditing sequence that covers the material in greater detail. For example, an introductory course might emphasize Chapters 1 through 10, 16, and 17. A second course may include coverage of the other procedural chapters (Chapters 11 through 15); integrated audits (Chapter 18); other attestation and accounting services; and internal, operational, and compliance auditing (Chapters 19, 20, and 21). The instructor might also wish to consider covering portions of Chapter 9 on sampling in the second course, with or without ACL software. Overall, the text and supporting materials provide:

1. **A balanced presentation.** The text provides a carefully balanced presentation of auditing and assurance theory and practice. The concepts are written in a clear, concise, and understandable manner. 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. **Organization around balance sheet accounts emphasized in previous accounting courses.** Organizing the text around balance sheet accounts is a particularly straightforward and user-friendly way to address the risk assessment-based approach to auditing required by both U.S. and international auditing standards. These standards require an in-depth understanding of the audited company and its environment, a rigorous assessment of the risks of where and how the financial statements could be materially misstated, and an improved linkage between the auditors' assessed risks and the particulars of audit procedures performed in response to those risks. Chapters 5 through 7 of the text describe the risk assessment approach in detail. Chapters 10 through 16 are aligned with the risk assessment approach presented in the professional standards. Accordingly, the suggested audit approach and procedures of the professional standards flow smoothly from the approach suggested in earlier chapters of the text. In short, our organization of the book facilitates student learning of the risk assessment process in a very straightforward manner. Also, although the text chapters are structured around balance sheet accounts, they include a significant amount of material on transaction cycles. For example, Chapters 10 through 13 include detailed coverage of revenue, cash receipts, acquisitions, and disbursements cycles.

3. **CPA examination support.** Both the text's emphasis on current auditing standards and its many objective questions (both multiple choice and other objective format) are aimed at helping students pass the CPA exam. As discussed in detail in the following section, this edition has significantly expanded the number of task-based simulations like the ones included on the CPA exam.
4. **Strong student and instructor support.** Both *Connect® Accounting* and the Online Learning Center provide 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/whittington19e.

We are confident that the 19th edition of *Principles of Auditing & Other Assurance Services* will provide students with a clear perspective of today's auditing environment.

O. Ray Whittington
Kurt Pany

Key Features of the Book

The first nine 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 1: Emphasizes the role of the public accountant, the structure of CPA firms, and the various types of audits and auditors. It also introduces the important concept of corporate governance and includes a brief history of the auditing profession, including up-to-date coverage of the Sarbanes-Oxley Act of 2002 and the Public Company Accounting Oversight Board.

Chapter 2: Includes detailed coverage of the new *Principles Underlying an Audit Conducted in Accordance with Generally Accepted Auditing Standards*, which replace the 10 generally accepted auditing standards for audits of nonpublic companies. An appendix highlights a number of differences between international and U.S. 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 the risk assessment standards is thoroughly integrated throughout.

Chapter 5: The discussion of evidence has been streamlined to parallel the presentation of evidence in recently issued auditing standards.

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

Chapter 7: Discusses internal control and how it is considered in an audit of financial statements. It also includes a brief overview of integrated audits (audits of internal control integrated with financial statement audits) required for certain public companies under PCAOB Standard No. 5, with more detailed coverage provided in Chapter 18. The chapter includes a section on the audit requirements when a client outsources its computer processing to a service organization. Finally, it presents the auditors' internal control communication responsibilities.

Students in auditing need familiarity with auditing standards promulgated by three different bodies: (1) the AICPA's Auditing Standards Board, (2) the Public Company Accounting Oversight Board, and (3) the International Auditing and Assurance Standards Board. While similar in most respects, key differences exist among these sets of standards. The text integrates discussions of the various standards, focusing on the differences, in a very readable manner.

This edition of the text has significantly expanded the number of task-based simulations included in the after-chapter problem material. These questions are designed to help students both to learn the material presented in the text and to prepare them to complete such questions on the CPA exam. Many of the task-based simulations are adapted from CPA exam questions released by the AICPA, and others were written by the authors to be similar to those released by the AICPA.

- 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

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.

- 8 Consideration of Internal Control in an Information Technology Environment
- 9 Audit Sampling
- 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

Chapter 8: Emphasizes the impact of IT on audits. It includes concepts such as "off-the-shelf" software packages through the use of cloud computing.

Chapter 9: Includes attributes and variable sampling. For variables sampling there are standalone discussions of classical methods and probability-proportional-to-size sampling.

Chapters 10 through 16: These "procedural chapters" deal with internal control and obtaining audit evidence for the various financial statement amounts. The chapters emphasize the risk-based approach stressed in recent AICPA, PCAOB, and international standards.

Chapter 17: Reflects new reporting requirements of the AICPA clarity standards, as well as coverage of PCAOB and international audit reports. Coverage of audits of group financial statements is updated in response to these standards.

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

Chapter 19: Updated to include current coverage of compilation and review engagements, auditor reporting on financial statements prepared using a special-purpose framework, and other changes due to the AICPA clarity standards.

Chapter 20: Discusses a variety of attestation and other assurance services. The material on attestation services describes the current professional standards. Recent pronouncements on service organization control (SOC) reports are included. 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."

New to This Edition

The 19th edition has been revised to reflect a number of events, to make the material more understandable, and to increase the scope of objective question coverage, including:

- **Clarity Standards.** The 18th edition of our text was the first on the market to comprehensively reflect the results of both the Auditing Standards Board and the International Auditing and Assurance Standards Board “clarity projects.” These projects completely revised and recodified both organizations’ standards in an effort to make them easier to read, understand, and apply. Yet, when the 18th edition was published, neither group had completed its recodification. This edition, published after completion of the clarity project, reflects all of the revised standards—standards that are now effective for both audits performed under the AICPA and international standards.
- **Audit Evidence.** The discussion of audit evidence in Chapter 5 has been shortened and follows the clarity standards more closely. This change is meant to make it easier for students to learn about the concepts related to audit evidence, concepts that carry over into the text’s procedural chapters (10 through 16).
- **Group Audits.** The clarity standards result in additional auditor responsibility in certain areas, including when a CPA firm has audited most but not all components of a company. In that situation, ordinarily, another audit firm (the component auditor) audited the remaining portion of the company. The audit requirements in this area are difficult for students to grasp. Accordingly, we have thoroughly revised the discussion of group audits in Chapter 17 of the text.
- **Service Organizations.** CPAs have long reported on activities of service organizations that provide processing services to customers who decide to outsource their processing of data. The text includes detailed coverage of the three recently developed forms of reports. Chapter 7 presents guidance on restricted-use reports on controls at a service organization relevant to a user entity’s internal control over financial reporting. Chapter 20 provides guidance on two additional types of reports, restricted-use and general-use reports on controls at a service organization related to security, availability, processing, integrity, confidentiality and/or privacy.
- **Objective Questions.** Throughout the text we have added objective questions, including task-based simulations. These questions address key concepts and are structured in the form students may expect to see on the CPA exam. They are also included in *Connect*®, thus making it easy for you to assign as work to be turned in and electronically graded. Details on *Connect* are provided later in this preface.


Additional changes include

- **Corporate Governance.** Chapter 1 includes an enhanced discussion of corporate governance as we expect that auditors in the future will work even more directly with audit committees (and equivalent organizations). Indeed *PCAOB Auditing Standard No. 16* on reporting to audit committees is a move in that direction.
- **PCAOB Standard Coverage.** PCAOB pronouncements up to and including *Auditing Standard No. 16* are included. Also, as indicated, coverage of Auditing Standards Board and International Auditing and Assurance Standards Board is updated.
- **Code of Professional Conduct Interpretation 101-3 Revision.** Chapter 3 includes the recent revision of Interpretation 101-3 relating to auditor independence.

Features of This Edition

Illustrative Cases

Actual business and accounting examples are used to illustrate key chapter concepts. The cases are boxed and appear throughout the text. New cases have been added for recent alleged audit failures. They are now subtitled for easy reference.

	Illustrative Case	<i>Indirect Financial Interests</i>
<p>John Bates, a partner and covered member in the public accounting firm of Reynolds and Co., owns shares in a regulated mutual investment fund, which in turn holds shares of stock in audit clients of Reynolds and Co. The public accounting firm inquired of the AICPA Professional Ethics Division whether this financial interest by Bates affected his independence with respect to the clients.</p> <p>The response was that this indirect interest would not normally impair the independence of the CPA, because investment decisions are made only by the mutual fund's management. However, if the portfolio of the mutual fund were heavily invested in securities of a client of Reynolds and Co., the indirect interest could become material to Bates and thereby impair his independence. Since Bates was found to be independent, his firm is independent.</p>		

Industry Focus Cases

These cases use examples from specific industries to provide students with a detailed, "real world" illustration of points being emphasized in the text. These cases show the importance of having a thorough knowledge of the audit client's business and industry. Like the Illustrative Cases, these cases are boxed and appear throughout the text.

Focus on the Airline Industry

Electronic ticketing has become basic to the airline industry. Under these systems a passenger may book a flight over the telephone or by computer and be assigned a reservation number rather than being issued a physical ticket. Since no ticket is created until the passenger checks in for the flight, the auditor is limited in the extent to which he or she can examine "paper" support for transactions. Accordingly, audit procedures should be developed relating to the associated revenues and receivables. Auditors often choose to test the computer controls in such situations.

Auditing Fair Value Information

As the accounting profession continues to value more assets and liabilities at their fair values, difficult audit issues often arise. The text includes integrated coverage of fair value accounting in Chapters 5, 10, 11, 13, and 16.