

CONTENTS

<i>Acknowledgements</i>	xiv
<i>Index of Legal Cases</i>	xvi
<i>Preface</i>	xvii
<i>Digital Support Resources</i>	xxiii

1 Why are auditors needed? 1

Learning objectives	1
Opening remarks	1
Introduction to basic principles through a simple case	5
Case Study 1.1: Andrew and James, Part 1	6
Case Study 1.1: Andrew and James, Part 2	7
Case Study 1.1: Andrew and James, Part 3	8
Case Study 1.1: Andrew and James, Part 4	10
Justification of audit	10
Introduction to truth and fairness in accounting	13
Basic audit framework	17
Some initial ideas on an extended role for audit	21
Assurance services	23
Summary of principles	23
Definition of an audit of financial and other information	25
The auditors' code: the fundamental principles of independent auditing	26
Current developments	28
Summary	29
Key points of the chapter	29
References	30
Further reading	30
Self-assessment questions (solutions available to students)	30
Self-assessment questions (solutions available to tutors)	31
Topics for class discussion without solutions	31

2 An overview of the postulates and concepts of auditing 32

Learning objectives	32
The importance of theory and concepts in underpinning auditing practice	32
The postulates of auditing	35
The concepts of auditing: credibility, process, communication, performance	38
Introduction to the audit expectations gap	51
Introduction to audit quality	53
Introduction to corporate governance	55
Public interest	57
The layers of regulation and control	58

Summary	63
Key points of the chapter	63
References	64
Further reading	65
Self-assessment questions (solutions available to students)	65
Self-assessment questions (solutions available to tutors)	65
Topics for class discussion without solutions	66

3 The meaning and importance of auditor independence: factors affecting independence and measures to attain it 67

Learning objectives	67
Introduction	67
Independence and the role of audit	68
Definitions of independence	71
Practitioner and profession independence	72
Conflict, power of auditor and client and effect on perceived independence	77
Published codes of ethics	83
Definition of independence in the IFAC Code	84
General principles of the IFAC Code	84
Audit firm's control environment	87
Safeguards to counter threats to integrity, objectivity and independence	94
Small entities	110
Other pronouncements on auditor independence	111
Summary	114
Key points of the chapter	115
References	116
Further reading	116
Self-assessment questions (solutions available to students)	116
Self-assessment questions (solutions available to tutors)	117
Topics for class discussion without solutions	117

4 Audit regulation 119

Learning objectives	119
The need for regulation	119
Company law regulation	123
Overview of the UK regulatory system in force until 2012	124
Financial Reporting Council (FRC)	126
The Professional Oversight Board (POB)	127
Accountancy and Actuarial Discipline Board (AADB)	128
Auditing Practices Board (APB)	129
Accounting Standards Board (ASB)	133
Financial Reporting Review Panel (FRRP)	133
Report of the Coordinating Group on Audit and Accounting (CGAA) issues	133
RSB audit monitoring	136
The current regulatory structure	137
Financial Reporting Council	139

Audit and Assurance Council	139
Conduct Committee	140
European Union influence	145
Further regulation of auditing by the law and accounting profession	147
The statutory and practical relationships	147
Rules on appointment, removal and resignation of the auditor	150
Case Study 4.1: Rosedale Cosmetics plc, Part 1	151
Case Study 4.1: Rosedale Cosmetics plc, Part 2	153
Case Study 4.1: Rosedale Cosmetics plc, Part 3	155
Case Study 4.1: Rosedale Cosmetics plc, Part 4	157
Case Study 4.1: Rosedale Cosmetics plc, Part 5	158
Small companies	161
Case Study 4.1: Rosedale Cosmetics plc, Part 6	162
Summary	163
Key points of the chapter	163
References	165
Further reading	165
Suggested solutions to tasks	165
Self-assessment questions (solutions available to students)	167
Self-assessment questions (solutions available to tutors)	168
Topics for class discussion without solutions	169

5 The risk-based approach to audit: audit judgement 171

Learning objectives	171
Why is a risk-based approach to audit an aid to the auditor?	171
Broad approach to minimize audit risk	174
A practical example	184
Case Study 5.1: Edengrove Limited	185
Other practical matters	186
Case Study 5.2: Kemback Limited, Part 1	190
Case Study 5.2: Kemback Limited, Part 2	193
Business risk approach to audit	195
Business risk and inherent risk approaches: similarities and dissimilarities	200
The business risk approach and smaller clients and smaller audit firms	203
Analytical review as a risk analysis tool	204
Judgement in accounting and auditing and its relationship to risk	205
Management of the audit process	208
The terms of reference provide the audit framework	209
Case Study 5.3: Hughes Electronics Limited	210
Planning the assignment	214
Case Study 5.4: County Hotel Limited, Part 1	214
Case Study 5.4: County Hotel Limited, Part 2	215
Summary	221
Key points of the chapter	221
References	223
Further reading	223

Suggested solutions to tasks	223
Self-assessment questions (solutions available to students)	226
Case Study 5.5: Cosmetics company: Fine Faces plc	226
Self-assessment questions (solutions available to tutors)	229
Topics for class discussion without solutions	230

6 The search for evidence explained 231

Learning objectives	231
The audit defined as a search for evidence to enable an opinion to be formed	231
Forming conclusions on the basis of evidence: the exercise of judgement	235
Reliability of audit evidence (grades of audit evidence)	239
Case Study 6.1: Ridgewalk plc	243
The business risk approach to gathering audit evidence	245
The stages of the audit process and the evidential requirements at each stage	248
Limited assurance and compilation engagements and agreed upon procedures	251
Conclusion	253
Summary	253
Key points of the chapter	254
Reference	255
Further reading	255
Self-assessment questions (solutions available to students)	255
Self-assessment questions (solutions available to tutors)	257
Topics for class discussion without solutions	258

7 Systems work: basic ideas 1 259

Learning objectives	259
Introduction	259
Layers of regulation and control expanded	261
Case Study 7.1: High Quality Limited (small independent supermarket)	274
Case Study 7.2: Entity in the financial services sector: Caipie Financial Services	276
Accounting and quality assurance/control systems	277
General controls	279
Case Study 7.3: Cash received system: Horton Limited	283
Summary	299
Key points of the chapter	299
References	301
Further reading	301
Self-assessment questions (solutions available to students)	301
Self-assessment questions (solutions available to tutors)	301
Topics for class discussion without solutions	302

8 Systems work: basic ideas 2 303

Learning objectives	303
Introduction	303

Application controls	303
Data capture/input controls	304
Processing controls	312
Output controls	314
Database systems	315
E-commerce	317
Audit approaches to systems and controls	323
Summary	343
Key points of the chapter	343
Further reading	344
Self-assessment questions (solutions available to students)	344
Self-assessment questions (solutions available to tutors)	345
Topics for class discussion without solutions	346

9 Testing and evaluation of systems 347

Learning objectives	347
Introduction	347
Sales and receivables system	348
Case Study 9.1: Broomfield plc: sales and trade receivables system	348
Payroll system	350
Case Study 9.2: Wages payroll: Troston plc	351
Purchases and trade payables system	353
Case Study 9.3: Broomfield plc: part of purchases and trade payables system	353
General and application controls in a sales system	355
Case Study 9.4: Burbage Limited	355
Tests of controls	357
Evaluation of systems and audit conclusions	369
Summary	371
Key points of the chapter	371
Reference	372
Further reading	372
Self-assessment questions (solutions available to students)	372
Self-assessment questions (solutions available to tutors)	374
Topics for class discussion without solutions	374

10 Substantive testing, computer-assisted audit techniques and audit programmes 375

Learning objectives	375
Introduction	375
Substantive testing of transactions, account balances and disclosures	375
Case Study 10.1: Powerbase plc: the substantive audit programme for purchases	377
The use of audit software	381
Directional testing	389
Substantive audit programmes for wages	391
Substantive audit programmes for cash and bank balances	393

Communication of audit matters to those charged with governance (management letter)	394
Audit management with the computer	399
Summary	402
Key points of the chapter	402
Reference	403
Further reading	403
Self-assessment questions (solutions available to students)	403
Self-assessment questions (solutions available to tutors)	404
Topics for class discussion without solutions	405
Appendix 10.1: Substantive audit programme for production wages: Troston plc	406
Appendix 10.2: Substantive audit programme for cash/bank: County Hotel Limited	409

11 Sampling and materiality 412

Learning objectives	412
Introduction	412
What is sampling?	413
Designing and selecting the sample for testing	413
Case Study 11.1: An example of judgemental sampling: Broomfield plc	415
Sample selection methodology	417
Evaluation of test results	421
Monetary unit sampling (MUS)	423
Comparative advantages of statistical and non-statistical sampling	424
Alternative statistical sampling methods	426
Materiality	427
Summary	439
Key points of the chapter	439
References	440
Further reading	441
Self-assessment questions (solutions available to students)	441
Self-assessment questions (solutions available to tutors)	442
Topics for class discussion without solutions	442

12 Final work: general principles, analytical review of financial statements, non-current assets and trade receivables 443

Learning objectives	443
Introduction	443
Pre-final work	444
Balance sheet date work	445
Bridging work between conclusion of interim work and the balance sheet date	447
Analytical procedures	447
Case Study 12.1: Kothari Limited: analytical review	451
Case Study 12.2: Art Aid Limited: analytical review	457
Detailed final audit work: general matters	461

Tangible non-current assets and depreciation	469
Case Study 12.3: Pykestone plc: non-current assets	469
Trade receivables and sales	486
Case Study 12.4: Sterndale plc: ageing statement	489
Case Study 12.5: Sterndale plc: analytical review of sales and trade receivables	491
Financial assets	502
Summary	505
Key points of the chapter	505
Further reading	507
Self-assessment questions (solutions available to students)	508
Self-assessment questions (solutions available to tutors)	508
Topics for class discussion without solutions	509

13 Final work: specific problems related to inventories, construction contracts, trade payables and financial liabilities 510

Learning objectives	510
Introduction	510
Inventories	511
Analytical procedures	516
Case Study 13.1: Billbrook Limited: analysis of inventory, Part 1	516
Case Study 13.1: Billbrook Limited: analysis of inventories, Part 2	517
Case Study 13.2: Greenburn Limited: inventory-taking instructions	523
Valuation of construction contracts	534
Case Study 13.3: Graves Limited: construction contracts	534
Trade payables and purchases	540
Analytical procedures	543
Financial liabilities	550
Summary	552
Key points of the chapter	552
Further reading	554
Self-assessment questions (solutions available to students)	554
Self-assessment questions (solutions available to tutors)	556
Topics for class discussion without solutions	556

14 Final review: post-balance sheet period, provisions, contingencies, letter of representation 557

Learning objectives	557
Introduction	557
Post-balance sheet events	558
Provisions, contingent liabilities and contingent assets	564
Going concern	573
Audit work to detect post-balance sheet events and contingencies	573
Evaluation of misstatements identified during the audit	576
Management letter of representation	578
Audit documentation	583
Role of the final review	587
Summary	588
Key points of the chapter	588

Further reading	590
Self-assessment questions (solutions available to students)	590
Self-assessment questions (solutions available to tutors)	591
Topics for class discussion without solutions	592

15 Assurance engagements and internal audit 593

Learning objectives	593
Introduction	593
Assurance engagements	594
Case Study 15.1: Protecting the environment in an area of scenic beauty	616
Case Study 15.2: Gilling Limited	619
Internal audit	622
Case Study 15.3: Greenburn Limited: fleet of vans	625
Case Study 15.4: Photocopy costs in an educational institution	627
Case Study 15.5: Barnton plc	628
How to make the internal audit function effective	630
Reliance on internal audit by the external auditor	633
Outsourcing of internal audit work	636
Case Study 15.6: Internal audit at Troston plc	637
Auditing in the public sector	639
The audit of charities	643
Summary	650
Key points of the chapter	651
References	653
Further reading	653
Self-assessment questions (solutions available to students)	654
Self-assessment questions (solutions available to tutors)	654
Topics for class discussion without solutions	656

16 The auditors' report 657

Learning objectives	657
Introduction	658
The unmodified opinion	659
The modified audit opinion	682
Disclaimer of responsibility	693
Reporting on corporate governance issues	694
Electronic publication of auditors' reports	704
Summary	705
Key points of the chapter	706
Reference	707
Further reading	707
Self-assessment questions (solutions available to students)	708
Self-assessment questions (solutions available to tutors)	710
Topics for class discussion without solutions	711

17 Fraud and going concern 713

Learning objectives	713
Introduction to fraud	713
Responsibility for fraud detection	715

Recent debates relating to fraud	727
Case law relating to fraud	731
Auditing Scandals	733
Consideration of law and regulations	735
Introduction to going concern	739
Directors' and auditors' responsibilities for going concern	740
Reporting on going concern	746
Summary	748
Key points of the chapter	748
References	750
Further reading	750
Appendix 17.1	751
Self-assessment questions (solutions available to students)	752
Self-assessment questions (solutions available to tutors)	752
Topics for class discussion without solutions	753

18 The audit expectations gap and audit quality 754

Learning objectives	754
The audit expectations gap	754
The causes of the audit expectations gap, possible developments and solutions	756
Audit quality	769
Conclusion on audit quality	779
Summary	779
Key points of the chapter	779
References	780
Further reading	781
Self-assessment questions (solutions available to students)	781
Self-assessment questions (solutions available to tutors)	782

19 Corporate governance 783

Learning objectives	783
Introduction to corporate governance	783
Models of corporate governance	786
The UK Corporate Governance Code	789
Board committees	795
The UK Stewardship Code	801
Audit firm corporate governance	805
Concluding remarks on corporate governance	805
Summary	806
Key points of the chapter	806
References	807
Further reading	807
Self-assessment questions (solutions available to students)	807
Self-assessment questions (solutions available to tutors)	808
Topics for class discussion without solutions	809

20 The auditor and liability under the law 811

Learning objectives	811
Introduction	811

Criminal liability	812
Civil liability	813
Case law	814
Auditing standards	829
Professional conduct	830
Potential ways of reducing auditor liability	831
Summary	837
Key points of the chapter	838
References	839
Further reading	839
Self-assessment questions (solutions available to students)	840
Self-assessment questions (solutions available to tutors)	842
Topics for class discussion without solutions	842
Appendix 20.1: Liability limitation agreement (example)	842

21 Issues in auditing 845

Learning objectives	845
Introduction	846
The accounting/auditing profession?	846
The setting of auditing standards	850
IFAC, the accountancy profession and globalization	853
Audit reporting	857
Going concern	864
Independence	868
Choice in the UK audit market	873
Some critics' view of the way forward	880
The audit society	882
Summary	896
Key points of the chapter	897
References	898
Further reading	900
Self-assessment questions (solutions available to students)	901
Self-assessment questions (solutions available to tutors)	901
Topics for class discussion without solutions	901

22 Examination hints and final remarks 902

Learning objectives	902
Introduction	902
General examination hints	902
Auditing as an examination subject	905
Final remarks	906

Credits 907

Index 908