



ACCG 340 - AUDITING AND ASSURANCE SERVICES

UNIT OUTLINE - SEMESTER 2, 2004

Student Resource Centre
Division of Economics
SYDNEY

1. UNIT DESCRIPTION

This unit is primarily concerned with the external audit of corporate financial statements. The lectures presented are structured to correspond with audit methodology used in practice and integrate Australian and International Auditing Standards.

The majority of the lectures deal with the various activities undertaken by auditors. The main stages of the audit process are addressed including planning, gathering and evaluating audit evidence (including performance of tests of controls and substantive audit procedures) and the formation of the audit opinion. Topics such as analytical procedures and computer assisted audit techniques are not treated as separate topics, but are integrated throughout the unit. Other topics, including auditors' legal responsibilities, ethics and assurance services, are dealt with as special topics.

The lectures mainly deal with the concepts underlying the methodology, while the tutorial material is designed to demonstrate how the methodology is applied in practical situations.

2. LECTURES

Attendance at lectures is highly recommended. There will be practical explanations and examples given in lectures which supplement the text material and tutorial questions. If you choose not to attend lectures, it would be wise to be aware of any announcements made in lectures that could affect your study. Lecture notes will be available on the unit webpage and in ERIC a few days prior to the lecture. It is the students responsibility to download and print these notes.

3. ASSESSMENT COMPONENTS

Tutorial work and participation	5%
On-line tests	10%
Mid-semester test	25%
Final examination	60%
	100%

To obtain a pass in the course, it is necessary to:

- (a) attempt ALL assessment components, and
- (b) obtain a pass in the final examination, and
- (c) obtain an overall passing grade for the course.

4. TUTORIALS

The objective of tutorial assignments is to apply audit theory to practical situations. Tutors will discuss the issues and difficulties students had in answering the questions. In addition, if time allows, some questions may be done during the tutorials.

Tutorial assignments must be submitted at the end of each tutorial on a weekly basis. Solutions will be made available at the beginning of the semester. It is required that students attempt all tutorial questions in writing and then compare their responses with the model answers. Responses that simply copy out the model solution will not be counted as work by the student. Students will receive a ½ mark for each complete tutorial. A complete tutorial is:

- Handwritten;
- Attempts all tutorial questions;
- Shows evidence of review against the model answer and in-class discussions; and
- Is submitted in the students' registered tutorial (not before, not after, not to the same tutor's class at a different time etc. etc.)

Tutors will not award marks for assignments that do not meet the above criteria under any circumstances. If you are unable to attend your tutorial due to illness or other reasons you will NOT receive any tutorial marks for that week (but remember its only worth ½ a mark). If you are unable to attend a number of tutorials due to a persistent illness or some other reason you must formally apply for special consideration in respect of your within-semester assessment.

Students may only attend their registered tutorial. Tutorial performance and attendance will be taken into account when considering any appeals for special consideration.

5. ONLINE TESTS

Three online tests will be conducted during the semester. These are accessible via the online web site: <http://online.mq.edu.au> Students will only have access if they are enrolled in the unit. If students cannot access the website they should contact Barbara Nevicky, Unit Administrator.

Details of the tests are as follows

	Date	Time test available online	No of questions	Time to complete	% of overall assesement
Test 1 Chapters 1&2	Friday 20 August	6am -11pm	5	10minutes	Nil (Practice)
Test 2 Chapters 3-6	Friday 10 September	6am-11pm	15	20minutes	5%
Test 3 Chapters 7-15 (exclud 11)	Friday 12 November	6am-11pm	15	20minutes	5%

6. MID-SEMESTER TEST AND FINAL EXAMINATION

The mid-semester test will be held on Sunday, 12 September 2004 at 10am. The test will be 90 minutes with ten minutes of reading time. It will encompass topics covered in weeks 1 to 5 inclusive.

Students who do not attend the mid-semester examination have until Friday 17 September to apply to the Lecturer in Charge for special consideration. Applications must be in writing and set out clearly the grounds for consideration. Students must provide documentary evidence to support their appeal. Results of appeals for special consideration will be posted on the unit webpage.

The final exam will be 2 hours with ten minutes reading time. Note that marks may be deducted for poor grammar, spelling and expression.

Material that is examinable is

- all material presented at lectures,
- all material included in the prescribed text readings (including all questions at the end of each chapter),
- all tutorial assignment questions, and
- material in the Auditing Handbook that is referred to in the lecture notes or that relates to tutorial assignment questions.

Note that the Auditing Handbook is NOT permitted to be taken into the final exam.

Please note that students who do not attend the officially time-tabled examination because of a misread timetable will automatically be given a failure grade (FA) and will not be given special consideration or permission to sit for supplementary examinations unless the student can demonstrate that the circumstances are so exceptional as to fall outside the reasonable application of the rule.

6. REFERENCE MATERIAL

All students should purchase from the Co-op Bookshop the following:

Gay, G. and Simnett, R., *Auditing and Assurance Services in Australia*, Second edition, McGraw-Hill Book Company Australia Pty Limited, 2003.

Strongly recommended:

Auditing Handbook: "Auditing Handbook 2004", being volume 2 of the Accounting and Auditing Handbook 2004, published by Prentice Hall.

The following texts are useful as additional references.:

Leung P., P. Coram, B. Cooper, G. Cosserrat and G. Gill, *Modern Auditing and Assurance Services*, 2nd Edition, John Wiley and Sons, 2004.

Schelluch, P., S. Topple, C. Jubb, L. Rittenberg and B. Schwieger Assurance and Auditing, Thompson, 2003

8. UNIVERSITY STAFF

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Please note that staff will only respond to emails that are sent by students from their Macquarie University email address.

9. WORLD WIDE WEB (WWW) SITE

Students can access the Web site for ACCG340 from either their home/office (via modem) or at University computers. The url is: <http://online.mq.edu.au>

10. SUPPLEMENTARY EXAMINATION

If a candidate, because of circumstances such as illness or misadventure, is unable to attend or performs unreasonably poorly in, the final examination, then he or she may submit a request for special consideration in accordance with Clauses 5 and 8 of the Bachelor Degree Regulations. Note that p37-38 of the 2004 Student Handbook set out the grounds on which special consideration may be applied for.

Although requests will be considered they are **not** automatically granted. The request must be fully supported by appropriate documentation. *Special consideration will only be granted where it is apparent that the stated circumstances disrupted previously satisfactory work.* The candidate should have fulfilled the other course requirements and there should be a reasonable expectation, based on other course work, of the candidate passing the course. Tutorial attendance and performance will also be taken into account when evaluating requests for special consideration.

A supplementary examination will be granted to those candidates to whom special consideration is given **and** where it is concluded that the absence of the candidate from, or the performance of the candidate in, *the final examination* was adversely affected by the circumstances described in the application. The application must be made in accordance with Clause 8(1) of the Bachelor Degree Regulations.

Returning overseas, going on holidays, demands of employment etc., are not grounds for deferral of the supplementary examination. Failure to attend the designated date of the supplementary examination will forfeit the candidates right to further special consideration.

11. THE DANGERS OF CHEATING AND PLAGIARISM AND HOW TO AVOID IT

UNIVERSITY POLICY ON PLAGIARISM:

What is Plagiarism?

The Academic Senate in June 2001 approved policies and procedures to ensure that the University takes a consistent and equitable approach to plagiarism. The Senate adopted the following definition of plagiarism.

Definition: Plagiarism involves using the work of another person and presenting it as one's own. Any of the following acts constitutes plagiarism unless the source of each quotation or piece of borrowed material is clearly acknowledged.

- i) copying out part(s) of any document or audio-visual material (including computer based material);
- ii) using or extracting another person's concepts, experimental results, or conclusions;
- iii) summarising another person's work;
- iv) in an assignment where there was collaborative preparatory work, submitting substantially the same final version of any material as another student.

Encouraging or assisting another person to commit plagiarism is a form of improper collusion and may attract the same penalties which apply to plagiarism. Opportunities and temptations for plagiarism have increased with the spread of internet access. Plagiarism is a serious threat to the teaching and accreditation process, and seriously undermines the collegial and ethical principles which underpin the work of a University.

The Dangers of Plagiarism and How to Avoid It

The integrity of learning and scholarship depends on a code of conduct governing good practice and acceptable academic behaviour. One of the most important elements of good practice involves acknowledging carefully the people whose ideas we have used, borrowed, or developed. All students and scholars are bound by these rules because all scholarly work depends in one way or another on the work of others.

Therefore, there is nothing wrong in a student using the work of others as a basis for their own work, nor is it evidence of inadequacy on the student's part, provided they do not attempt to pass off someone else's work as their own.

To maintain good academic practice, so that a student may be given credit for their own efforts, and so that their own contribution can be properly appreciated and evaluated, they should acknowledge their sources and they should ALWAYS:

- i) state clearly in the appropriate form where they found the material on which they have based their work,
- ii) acknowledge the people whose concepts, experiments, or results they have extracted, developed, or summarised, even if they put these ideas into their own words;
- iii) avoid excessive copying of passages by another author, even where the source is acknowledged. Find another form of words to show that the student has thought about the material and understood it, but stating clearly where they found the ideas.

If a student uses the work of another person without clearly stating or acknowledging their source, the result is falsely claiming that material as their own work and committing an act of PLAGIARISM. This is a very serious violation of good practice and an offence for which a student will be penalised.

A STUDENT WILL BE GUILTY OF PLAGIARISM if they do any of the following in an assignment, or in any piece of work which is to be assessed, without clearly acknowledging their source(s) for each quotation or piece of borrowed material:

- i) copy out part(s) of any document or audio-visual material, including computer-based material;
- ii) use or extract someone else's concepts or experimental results or conclusions, even if they put them in their own words;
- iii) copy out or take ideas from the work of another student, even if they put the borrowed material in their own words;
- iv) submit substantially the same final version of any material as a fellow student. On occasions, a student may be encouraged to prepare their work with someone else, but the final form of the assignment must be their own independent endeavour.

Examples

Examples of plagiarism, scaled from the mildest to most serious offences, which may be collectively known as "The Plagiarism Continuum" (Walker, J. (1998) "Student Plagiarism in Universities: What Are We Doing About it?" Higher Education Research and Development, 17, 1, 89-105) are provided on the following web page: www.student.mq.edu.au/plagiarism The web site also includes the procedures approved by Academic Senate to be followed in cases of suspected plagiarism.

Penalties

Offences of plagiarism will attract penalties which may vary from counselling and a warning, the deduction of all marks for the assignment, to failure in the unit and reference to the University Discipline Committee. The penalty will depend upon the extent of the plagiarism, whether it is a first or repeated offence, whether there is evidence of deliberate deceit and whether advantage has been taken of another student.

12. DETAILED COURSE OUTLINE

Schedule of topics		
Week No	Week Commencing	Topic
1	2 August	Introduction to audit and assurance services and the auditing profession
2	9 August	Ethics
3	16 August	Legal responsibilities (Video: The Auditor in Court) [On-line test 1]
4	23 August	Elements of the financial reporting audit process
5	30 August	Knowledge of the business and evaluating strategic business risk (Video: How to Detect and Prevent Financial Statement Fraud)
6	6 September	<i>No Lectures this week but tutorials are still held.</i> [On-line test 2] <i>Mid Term Examination Sunday 12th September</i>
7	13 September	Conception Day – No Lectures or Tutorials Self Study Topic - Assurance Services and Internal Auditing
8	4 October	Inherent risk assessment and materiality (Video: 4 Corners – HIIH Report)
9	11 October	Internal control structure and assessing control risk
10	18 October	Tests of Controls
11	25 October	Substantive tests of transactions and balances
12	1 November	Completing the audit/Opinion formulation
13	8 November	Revision [On-line test 3]

Lecture 1

Introduction to audit and assurance services and the auditing profession

References:

Gay and Simnett Chapters 1 and 2.
AUS 106 Explanatory Framework for Standards on Audit and Audit Related Services
AUS 206 Quality Control for Audit Work

Tutorial Questions:

1.21, 1.22, 1.25, 1.28, 2.24, 2.30

Lecture 2

Professional ethics and legal responsibilities

References:

Gay and Simnett Chapter 3

AUP 32: Audit Independence
CPC Joint Code of Professional Conduct
AUS 210 Irregularities, Including Frauds, and Other Illegal Acts and Errors
AGS 1014 Privity Letter Requests

Tutorial Questions:

3.16, 3.20, 3.24, 3.26, 3.30

Lecture 3

Legal responsibilities

Video:

The Auditor in Court (see page 10 of unit outline for questions relevant to the video)

References:

Gay and Simnett Chapters 4

AUS 210 Irregularities, Including Frauds, and Other Illegal Acts and Errors
AGS 1014 Privy Letter Requests

Tutorial Questions:

4.17, 4.18, 4.25, 4.28, 4.30

Lecture 4

Elements of the Financial Reporting Audit Process

References:

Gay and Simnett Chapter 5

AUS 208: Documentation
AUS 402: Risk Assessments and Internal Controls
AUS 502: Audit Evidence

Tutorial Questions:

5.17, 5.22, 5.24, 5.26, 5.30

The Auditor in Court

Issues to consider while watching the tape

Part 1. Planning Supervision and Control

The auditor failed to comply with the requirement that the auditor should properly plan, supervise and control the audit and keep a full record of the work done.

- A) List as many errors the auditors made as you can.
- B) How can they be avoided?

Part 2. Accounting Systems and Internal controls

There are two different systems on which the auditor wrongly placed reliance.

- A) What were the two systems?
- B) How did they fail?
- C) What was the extent of misstatement?

Part 3. Audit Evidence

The auditors failed to carry out procedures designed to gather sufficient appropriate evidence resulting in failure to discover four errors.

- A) What were the 4 errors?
- B) What was the audit failure?

We will not watch part 4 of the tape.

CRAZY EDDIE, INC.

WHERE WERE THE AUDITORS?

When the scale of the Crazy Eddie fraud was revealed to the public, the question on the minds of many investors, creditors, and other interested parties was, "Where were the auditors?" when all this chicanery was occurring. Four different accounting firms audited Crazy Eddie's financial statements over its turbulent history. Antar dismissed Crazy Eddie's first accounting firm, a local firm, before he took the company public. The underwriting firm that managed Crazy Eddie's initial public offering urged Antar to retain a more prestigious accounting firm to increase the public's confidence in the company's financial statements. As a result, Antar retained Main Hurdman to serve as Crazy Eddie's audit firm. Main Hurdman had a nationwide accounting practice with several prominent clients in the consumer electronics industry. In the mid-1980s, Peat Marwick became Crazy Eddie's audit firm when it merged with Main Hurdman. Following the corporate takeover of Crazy Eddie in 1987, Peat Marwick was replaced by Touche Ross.

Much of the criticism stemming from the Crazy Eddie scandal focused on Main Hurdman and its successor, Peat Marwick. Published reports suggest that the audit fees charged Crazy Eddie by Main Hurdman were unreasonably low. In one year, the accounting firm reportedly charged Crazy Eddie only \$85,000 for a full-scope independent audit—an audit of a firm that had several hundred million dollars of revenues. A leading critic of major accounting firms alleged that Main Hurdman had "lowballed" to obtain the Crazy Eddie audit, realizing that it could make up for any lost audit revenue by selling the company consulting services.

In one year, Main Hurdman charged only \$85,000 to do a complete audit of Crazy Eddie—a business with hundreds of millions of dollars in reported revenues, dozens of retail stores, and two large warehouses. At the very same time that Main Hurdman was charging the bargain basement price of \$85,000 for supposedly conducting an audit, its consulting division was charging Crazy Eddie millions of dollars to computerize Crazy Eddie's inventory system.⁵

Extract from:

Knapp M.C., "Contemporary Auditing: Real Issues and Cases
4th Edition, ISACA, 2001.

This same individual questioned Main Hurdman's ability to objectively audit an inventory system that it had effectively developed. Main Hurdman's independence was also questioned because many of Crazy Eddie's accountants were former members of that accounting firm. Critics charge that a company that hires one or more of its former auditors can more easily conceal fraudulent activities during the course of subsequent audits. That is, a former auditor may help his or her new employer undermine subsequent audits. Crazy Eddie's hiring of several of its former auditors was not unusual; auditors often accept positions with former clients when they leave public accounting. Many accounting firms actually arrange such "placements," a practice that has been widely challenged.

You would think that if an auditor wanted to leave a public accounting firm, he or she would be discouraged from going to work for clients they had audited. Instead, just the opposite is true with big accounting firms encouraging their personnel to work for clients in the apparent belief that it helps cement the accountant-client relationship.⁵

Most of the criticism directed at Crazy Eddie's auditors stemmed from their failure to uncover the huge overstatement of the company's inventory and the related understatement of accounts payable. Third parties who filed suit against the auditors charged them with "aiding and abetting" the fraud by failing to thoroughly investigate numerous suspicious circumstances they discovered. Of particular concern were several reported instances in which the auditors requested client documents, only to be told that those documents had been lost or inadvertently destroyed.

In Peat Marwick and Main Hurdman's defense, Antar and his associates engaged in a large-scale plan to deceive the auditors. For example, after discovering which inventory sites the auditors would be visiting at year-end, Antar would ship sufficient inventory to those stores or warehouses to conceal any shortages. Likewise, Crazy Eddie personnel systematically destroyed incriminating documents to conceal inventory shortages from the auditors. Antar also ordered his employees to stop using the sophisticated, computer-based inventory system designed by Main Hurdman. Instead, the accounting personnel were required to return to an archaic manual inventory system previously used by the company. The absence of a computer-based inventory system made it much more difficult for the auditors to determine exactly how much inventory the firm had at any point in time.

A particularly disturbing aspect of the Crazy Eddie scandal was the involvement of several key accounting employees in the various fraudulent schemes. Among the parties who were charged with participating in the fraud or being aware of it were the director of the internal audit staff, the acting controller, and the director of accounts payable. Past experience has proven that a fraud involving the collusion of numerous client executives, particularly key accounting personnel, is extremely difficult for auditors to uncover.

5. M.I. Weiss, "Auditors: Be Watchdogs, Not Just Bean Counters," *Accounting Today*, 15 November 1993, 41.

6. *Ibid.*, 42.

CRAZY EDDIE'S

How to Detect and Prevent Financial Statement Fraud

- **Asset/Revenue Understatements**
eg: to reduce income taxes
 skimming money
 no internal control / no documentation

- **Assessing the Risk of Fraud**
Domination of board / management
Reduce Tax Liability
Increase Profitability
Weak Monitoring I/C
Weak internal controls
Non financial personnel in accounting function
High obsolescence
Significant banking transactions overseas

- **Misstatements as a result of:**

Understated	Liabilities
	Expenses
Overstated	Assets
	Revenues

- **Achieved by:**
 - 1) **Timing Difference (recording in wrong period)**

(a) Early revenue recognition (record July Sales in June)
(b) Delay expense recognition (record June Exp in July)

Steps to detect
 - Cut off examination of journals etc. especially bank account
 eg: deposits in transit
 - Verify dates outside company
 - Inquire of staff regarding dates

 - 2) **Fictitious Income (false sales)**

Steps to detect
 - Examine all significant or unusual journal entries
 - Confirm sales and sales documentation
 - Examine unusual sales transactions

 - 3) **Returns Allowance and Warranties**

Steps to detect
 - Examine Warehouse
 - Offsite storage
 - Analytical Review

- Contact customers
- Interview vendors to confirm returns

4) Concealment of Liabilities and Expense

- (a) Fail to record liabilities
 Conceal liabilities (in a draw)

Steps to detect

- Search for unrecorded liabilities
- Examine payment after balance sheet date
- Interview suppliers
- Examine draws
- Interview employees

- (b) Record Expense as an asset

Steps to detect

- Ensure adequate classifications

5) Improper Valuation of Asset

- (a) Inventory
 eg: False inventory counts

Steps to detect

- Unit price reasonable - check invoice price
- Check alteration of price / counts
- Compare prior years
- Be alert! Care with work papers

- (b) Accounts Receivable

Steps to detect

- Look for unusual transactions
- Look customers up in the phone book

- (c) Fixed Assets (overvalue assets)

Steps to detect

Detection of capitalized Expense

- Examine source documents
- Check classification - particularly S/T → L/T
- Interview

6) Improper Disclosures

- Liability omission eg: warranties contingency
- Related Party transactions
- Change in accounting policy

Steps to detect

- Require personal financial disclosures from management

<p style="text-align: center;">Lecture 5 Knowledge of the Business and Evaluating Strategic Business Risk</p>

Video:

How to Detect and Prevent Financial Statement Fraud (see pages 12-15 of the unit outline for material related to the video)

References:

Gay and Simnett Chapter 6
AUS 204: Terms of Audit Engagement
AUS 206: Quality Control for Audit Work
AUS 302: Planning
AUS 304: Knowledge of the Business
AUS 510: Initial Engagement – Opening Balances
AUS 512: Analytical Procedures

Tutorial Questions:

6.16, 6.21, 6.26, 6.29

Prior to Lecture 6 read the case study material on HIH on the text web page

http://highered.mcgraw-hill.com/sites/0074711709/student_view0/case_studies.html

<p style="text-align: center;">Lecture 6 – <i>Self Study</i> Other Assurance Services and Internal Auditing</p>

References:

Gay and Simnett Chapter 14 and 15

Tutorial Questions:

14.26, 14.28, 15.15, 15.20

<p style="text-align: center;">Lecture 7 Inherent Risk Assessment and Materiality</p>

Video:

HIH Report –Odds on to Fail

References:

Please read the following material on the HIH case prior to watching the video

http://highered.mcgraw-hill.com/sites/0074711709/student_view0/case_studies.html

Gay and Simnett Chapter 7

AUS 302 Planning

AUS 306: Materiality

AUS 402: Risk Assessment and internal controls

AUS 502: Audit Evidence

AUS 708: Going Concern

Tutorial Questions:

7.13, 7.14, 7.19, 7.22, 7.25

<p style="text-align: center;">Lecture 8 Internal Control Structure and Assessing Control Risk</p>
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References:

Gay and Simnett Chapter 8

AUS 214 Auditing in a CIS Environment

AUS 402: Risk Assessments and Internal Controls

AUS 404 Audit Implications Relating to Entities using a Service Entity

AUS 604 Considering the work of Internal Auditing

Tutorial Questions:

8.19, 8.25, 8.30

Lecture 9

Tests of Controls

References:

Gay and Simnett Chapter 9

AUS 214 Auditing in a CIS Environment
AUS 402: Risk Assessments and Internal Controls
AUS 502: Audit Evidence

Tutorial Questions:

9.24, 9.27, 9.28

Lecture 10

Substantive Tests of Transactions and Balances

References:

Gay and Simnett Chapter 10

AUS 502: Audit Evidence
AUS 504: External Confirmation.
AIUS 506: Existence and Valuation of Inventory
AGS 1002: Bank Confirmation Requests

Tutorial Questions:

10.18, 10.23, 10.32, 10.34

Lecture 11

Completing the audit – Opinion Formulation

References:

Gay and Simnett Chapter 12 and 13

AUS 520 Management Representations
AUS 702 The Audit Report on a General Purpose Financial report
AUS 706 Subsequent Events
AUS 708 Going Concern

Tutorial Questions:

12.11, 12.14, 12.22, 12.30, 13.24, 13.30