



MACQUARIE
UNIVERSITY ~ SYDNEY

MACQUARIE UNIVERSITY

ACCG 340 – AUDITING & ASSURANCE SERVICES

UNIT OUTLINE – SEMESTER 1, 2005

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MACQUARIE UNIVERSITY
DIVISION OF ECONOMICS AND FINANCIAL STUDIES
UNIT OUTLINE ACCG 340

Year and Semester: 2005 Semester 1

Unit Convenor: Renee Radich

[Prerequisites / Corequisites:] ACCG 310 (P), ACCG 250 (P)

Students in this unit should read this unit outline carefully at the start of semester. It contains important information about the unit. If anything in it is unclear, please consult one of the teaching staff in the unit.

ABOUT THIS UNIT

UNIT DESCRIPTION (3 undergraduate credit points)

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.

TEACHING STAFF

Convenor: Renee Radich
Room C5C 424
Phone 9850 8534
Email: rradich@efs.mq.edu.au
Consultation hours: Thursday 2pm-6pm

Neil Fargher

Room: C5C 432

Phone: 9850 9281

Email: nfargher@efs.mq.edu.au

Consultation hours: Wednesday 2-4pm

Parmod Chand

Room: C5C 416

Phone: 9850 6137

Email: pchand@efs.mq.edu.au

Consultation hours: Friday 8-10am

Kym Boon

Room: C5C 401

Phone: 9850 8451

Email: kboon@efs.mq.edu.au

Consultation hours: Friday: 2:30 – 4:30pm

Kirsty O’Gorman (Unit Administrator)

Room C5C 418

Phone 9850 9177

Email: kogorman@efs.mq.edu.au

Consultation hours: Friday 10:30 – 12:30pm

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

CLASSES

The timetable for classes can be found on the University web site at:

<http://www.timetables.mq.edu.au/>

LEARNING OUTCOMES

This unit seeks to develop both generic skills and specific knowledge. A student passing this course must master specific knowledge of the audit process. In order to conduct effective audits a student will also develop their ability for critical analysis, problem solving, creative thinking and ethical reasoning. The ability to plan and implement the gathering of evidence, and the critical analysis of evidence, is a valuable skill that extends beyond the specific area of auditing financial statements.

TEACHING AND LEARNING STRATEGY

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 powerpoint slides 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 slides.

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 in the week following each tutorial. It is required that students attempt all tutorial questions in writing. Simply copying out a 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 it's 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
Please note that any changes to tutorial classes MUST be done online.

REQUIRED AND RECOMMENDED TEXTS

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 2005", being volume 2 of the Accounting and Auditing Handbook 2005, published by Prentice Hall.

The following texts are useful as additional references.:

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

WORLD WIDE WEB (WWW) SITES

Web CT

Students can access the Web site for ACCG 340 from either their home/office (via modem) or at University computers.

The url is: <http://online.mq.edu.au>

myMQ : Macquarie Student Portal

The Student Portal is now available to all students. myMQ, the student portal, provides the gateway to information for current students. The myMQ Portal has been designed to bring all student resources to one location to access all of their university resources. The Portal contains links to:- Student Email-Calendar- On Line Teaching Facility- Library catalogue and reserve systems- eStudent - Unit home pages- and many other student and university resources. Additional services will be added throughout the year and future initiatives will include a portal for University staff.

The Student Portal home page is located at <https://my.mq.edu.au>

RELATIONSHIP BETWEEN ASSESSMENT AND LEARNING OUTCOMES

The following forms of assessment will be undertaken during the semester:

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.

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 Kirsty O’Gorman – Unit Administrator.

Details of the tests are as follows:

	Date	Time test available online	No of questions	Time to complete	% of overall assessment
Test 1 Chapters 1&2	Saturday 19 March	6am -11pm	5	10minutes	Nil (Practice)
Test 2 Chapters 3-6	Saturday 7 May	6am-11pm	15	20minutes	5%
Test 3 Chapters 7-15 (exclude 11)	Saturday 11 June	6am-11pm	15	20minutes	5%

MID-SEMESTER TEST

The mid-semester test will be held on **Friday 15th April at 5pm**. The test will be 90 minutes with ten minutes of reading time. It will encompass topics covered in topics 1 to 5 inclusive.

Students who do not attend the mid-semester examination have until Friday 22 April 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.

FINAL EXAMINATION

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.

The university examination period for semester 1 2005 is from 15 June to 29 June 2005. You are expected to present yourself for examination at the time and place designated in the Examination Timetable. The timetable will be in draft form before the commencement of the examinations.

<http://www.timetables.mq.edu.au/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.

The only exception to not sitting an examination at the designated time is because of documented illness or unavoidable disruption. In these circumstances you may wish to consider applying for Special Consideration. Information about unavoidable disruption and the special consideration process is available at <http://www.reg.mq.edu.au/Forms/APSCon.pdf>

If a Supplementary Examination is granted as a result of the Special Consideration process the examination will be scheduled after the conclusion of the official examination period.

You are advised that it is Macquarie University policy not to set early examinations for individuals or groups of students. All students are expected to ensure that they are available until the end of the teaching semester, that is the final day of the official examination period.

PLAGIARISM

The University defines plagiarism in its rules: "Plagiarism involves using the work of another person and presenting it as one's own. "Plagiarism is a serious breach of the University's rules and carries significant penalties. You must read the University's practices and procedures on plagiarism. These can be found in the *Handbook of Undergraduate Studies* or on the web at: <http://www.student.mq.edu.au/plagiarism/>

The policies and procedures explain what plagiarism is, how to avoid it, the procedures that will be taken in cases of suspected plagiarism, and the penalties if you are found guilty. Penalties may include a deduction of marks, failure in the unit, and/or referral to the University Discipline Committee.

UNIVERSITY POLICY ON GRADING

Academic Senate has a set of guidelines on the distribution of grades across the range from fail to high distinction. Your final result will include one of these grades plus a standardised numerical grade (SNG).

On occasion your raw mark for a unit (i.e., the total of your marks for each assessment item) may not be the same as the SNG which you receive. Under the Senate guidelines, results may be scaled to ensure that there is a degree of comparability across the university, so that units with the same past performances of their students should achieve similar results.

It is important that you realise that the policy does not require that a minimum number of students are to be failed in any unit. In fact it does something like the opposite, in requiring examiners to explain their actions if more than 20% of students fail in a unit.

The process of scaling does not change the order of marks among students. A student who receives a higher raw mark than another will also receive a higher final scaled mark.

For an explanation of the policy see

<http://www.mq.edu/senate/MQUonly/Issues/Guidelines2003.doc> or
<http://www.mq.edu.au/senate/MQUonly/Issues/detailedguidelines.doc>

STUDENT SUPPORT SERVICES

Macquarie University provides a range of Academic Student Support Services. Details of these services can be accessed at:

<http://www.student.mq.edu.au>

DETAILED COURSE OUTLINE

Schedule of topics			
Week No	Week Commences	Lecturer	Topic
1	28 Feb	NF	Introduction to audit and assurance services and the auditing profession
2	7 March	NF	Ethics
3	14 March	NF	Legal responsibilities (Video: The Auditor in Court) [On-line test 1]
4	21 March		PUBLIC HOLIDAY – No tutorials or lectures this week
5	28 March	PC	Elements of the financial reporting audit process
6	4 April	KB	Knowledge of the business and evaluating strategic business risk (Video: How to Detect and Prevent Financial Statement Fraud)
7	11 April		MID-SEMESTER EXAM –No tutorials or lectures this week.
8	2 May	KB	Inherent risk assessment and materiality (Video: 4 Corners – HIH Report) [On-line test 2]
9	9 May	PC	Internal control structure and assessing control risk
10	16 May	PC	Tests of Controls
11	23 May	KB	Substantive tests of transactions and balances
12	30 May	KB	Completing the audit/Opinion formulation
13	6 June	NF	Assurance Services and Internal Auditing [On-line test 3]

Lecturers:

NF = Neil Fargher
PC = Parmod Chand
KB = Kym Boon

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:

1.11, 1.12, 1.16, 1.18, 1.27, 2.22, 2.26, 2.29

Lecture 2

Professional ethics

References:

Gay and Simnett Chapter 3

CPC Joint Code of Professional Conduct

AUS 210 Irregularities, Including Frauds, and Other Illegal Acts and Errors

AGS 1014 Privity Letter Requests

Tutorial Questions:

3.10, 3.14, 3.15, 3.19, 3.25, 3.29

<p style="text-align: center;">Lecture 3 Legal responsibilities</p>

Video:

The Auditor in Court (see following page in 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 Privity Letter Requests

Tutorial Questions:

4.5, 4.8, 4.23, 4.27, 4.29

<p style="text-align: center;">Lecture 4 Elements of the Financial Reporting Audit Process</p>
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References:

Gay and Simnett Chapter 5

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

Tutorial Questions:

5.21, 5.23, 5.25, 5.26, 5.27, 5.29

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.

Lecture 5

Knowledge of the Business & Evaluating Strategic Business Risk

Video:

How to Detect and Prevent Financial Statement Fraud (see the following pages 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:

6.14, 6.19, 6.23, 6.24, 6.28

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

Lecture 6

Inherent Risk Assessment and Materiality

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:

7.10, 7.13, 7.21, 7.23, 7.24

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.⁶

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.J. 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

Lecture 7
Internal Control Structure & Assessing Control Risk

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:

8.18, 8.21, 8.24, 8.26

Lecture 8
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:

9.19, 9.20, 9.26, 9.27

Lecture 9
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:

10.16, 10.20, 10.24, 10.29, 10.31

<p style="text-align: center;">Lecture 10 Completing the audit – Opinion Formulation</p>
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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:

12.13, 12.16, 12.19, 12.26, 13.25, 13.26

<p style="text-align: center;">Lecture 11 Other Assurance Services and Internal Auditing</p>
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References:

Gay and Simnett Chapter 14 and 15

Tutorial Questions:

14.20, 14.25, 14.29, 15.13, 15.17