Since the release of the Canadian edition of this book, a number of important changes have occurred that affect the auditing profession. First, the profession has continued to develop a revised audit process that relies on a broader view of the entity being audited and its environment. This process looks at the business risks faced by the entity and how it controls those risks. The audit approach then evaluates how the entity’s control processes manage those business risks and focuses on auditing the residual risks. This new audit process is intended to provide a more effective and efficient audit. Second, various groups continue to demand that auditors assume more responsibility as part of their role in society. This is especially true in terms of the auditor’s responsibility to detect fraud. The dramatic recent events surrounding the bankruptcy of companies such as Enron, WorldCom, and Global Crossings have reinforced these concerns. Third, auditors are expanding their product offerings to include additional assurance services such as assurance on information systems reliability, e-commerce, and health care measurement. Finally, technology continues to have a significant effect on clients and auditors. E-commerce and highly integrated information systems create opportunities and risks for both the auditee and auditor.

To respond to these changes (and challenges), the authors continue to believe our students are best served by understanding the basic concepts that underlie the audit process and how to apply those concepts to various audit and assurance services. The Second Canadian edition of *Auditing and Assurance Services: A Systematic Approach* contains significant changes and revisions that respond to this changing environment. Chapters 1 and 20 contain more detailed coverage of assurance, attestation and auditing services including discussion of the demand for assurance services and how the provision of such services responds to the need for entities to be accountable to different groups in society.

Extensive revisions have been made to Chapter 3. At the time of writing (June 2004), the CICA has just issued a major new exposure draft dealing with the topics of materiality and audit risk. To promote international harmonization, the exposure draft follows very closely the contents of International Standard on Auditing (ISA) 330 and ISA 315, with minor editorial changes as necessary to maintain consistency with current *Handbook* terminology and to replace references to other ISAs with appropriate *Handbook* references. It contains new sections that will be added to the
Handbook, changes to the content of existing Handbook sections, and deletes Handbook sections made redundant. It is the stated intention of the CICA to incorporate the changes presented in the Exposure Draft into the CICA Handbook to be effective for companies with year-ends ending on or after December 15, 2005. Chapter 3 has been revised to reflect the new standards and guidance in the expectation that the new Canadian standards will be incorporated into the Handbook as presented in the Exposure Draft with little or no further modification. Chapter 3 also includes an introduction to the Strategic Systems Approach to auditing and the concept of Key Business Processes, as well as an expanded discussion of the auditor’s responsibility for fraud. The revised audit process has been integrated throughout the relevant chapters.

The new approach to audit risk combines the auditor’s assessment of inherent risk and control risk into the assessment of the risk of material misstatement. The CICA has indicated that in assessing the risk of material misstatement it is appropriate to treat inherent risk and control risk globally or separately. Chapters 9 to 15 of Part V, covering applications to specific business processes, follow the latter approach.

The case material for EarthWear Clothiers, a mail-order retailer, which is used throughout the book, has been updated. There are Internet home pages for EarthWear and its auditors. EarthWear’s home page has assurance provided through a CA WebTrustSM engagement.

The text has a new design format, revised learning objectives, updated multiple-choice questions and problems, and new Internet assignments.

As the title indicates, the book takes a systematic approach to the audit process by first introducing the three basic concepts underlying that process: materiality, audit risk, and evidence. These concepts are then applied to each major business process and related account balances using a risk-based approach. For example, each business process chapter starts with an overview of the information system followed by a discussion of inherent risk factors that are relevant for the business process and account balances. The assessment of control risk is then described, followed by discussion of the nature, timing, and extent of audit procedures necessary to obtain sufficient evidence to reach the appropriate level of detection risk.

In covering these important concepts and their applications, the book focuses on the decision-making processes followed by auditors. Much of auditing practice involves the use of auditor judgment. If a student understands these basic concepts and how to apply them on an audit engagement, he or she will know how to practice in today’s dynamic audit environment.

The book can be used in a one-semester introductory auditing or assurance services course, or in a two-course sequence at the undergraduate and graduate levels. It can also be used in introductory professional development courses for external auditors, internal auditors, and government auditors.
Organization

*Auditing and Assurance Services: A Systematic Approach* is divided into eight parts:

<table>
<thead>
<tr>
<th>Part</th>
<th>Description</th>
<th>Chapters</th>
</tr>
</thead>
<tbody>
<tr>
<td>I</td>
<td>Introduction to Auditing and Assurance Services</td>
<td>1–2</td>
</tr>
<tr>
<td>II</td>
<td>Basic Auditing Concepts: Materiality, Risk, and Evidence</td>
<td>3–4</td>
</tr>
<tr>
<td>III</td>
<td>Planning the Audit and Understanding Internal Control</td>
<td>5–7</td>
</tr>
<tr>
<td>IV</td>
<td>Audit Testing</td>
<td>8</td>
</tr>
<tr>
<td>V</td>
<td>Auditing Business Processes</td>
<td>9–15</td>
</tr>
<tr>
<td>VI</td>
<td>Completing the Audit and Reporting Responsibilities</td>
<td>16–17</td>
</tr>
<tr>
<td>VII</td>
<td>Professional Responsibilities</td>
<td>18–19</td>
</tr>
<tr>
<td>VIII</td>
<td>Accounting Services, Attest Engagements, and Assurance Services</td>
<td>20</td>
</tr>
</tbody>
</table>

**Part I: Introduction to Auditing and Assurance Services**

This part of the textbook introduces assurance services, attest services, and auditing. Chapter 1 reviews the demand for assurance services and the role of assurance services in today's economy; the relationship between assurance, attest services, and auditing; the types of audit engagements and types of auditors; and the public accounting profession, including issues faced by the profession; organizations that impact the profession; and auditing standards. The Appendix to Chapter 1 also describes EarthWear Clothiers, a fictitious company based on a real-world entity. This case is used throughout the text to demonstrate important concepts. EarthWear and its auditors have websites that can be used for various case assignments. Chapter 2 provides a unique overview of financial statement audits. It covers the management assertions contained in financial statements and their relationship to audit objectives, the auditor's responsibility for errors and fraud, and the auditor as a business and industry expert; and it covers the three fundamental concepts that underlie the audit process: materiality, audit risk, and evidence. The chapter also includes a brief overview of sampling, ethics and independence, and audit reporting.

**Part II: Basic Auditing Concepts: Materiality, Risk, and Evidence**

Part II provides extensive coverage of the three basic concepts that underlie the audit process. Chapter 3 discusses materiality and audit risk and their role in the auditor's decision-making process. In Chapter 3 the student is introduced to the *Strategic Systems Approach* to auditing, an approach increasingly being adopted by large firms as a way of managing audit risk and business risk, and providing efficient and effective audits. Chapter 4 provides detailed coverage of the concepts related to audit evidence, including the various types of evidence used by auditors and the basics of working paper documentation.
Part III: Planning the Audit and Understanding Internal Control

Part III is devoted to audit planning and understanding internal control. Chapter 5 outlines an organized approach to audit planning and describes the different types of audit tests, with detailed coverage of analytical procedures. Chapter 6 covers the auditor’s consideration of internal control when planning and performing an audit, including the basic framework for assessing control risk. A new section that discusses the impact of information technology on internal control is also included. Chapter 7 extends the coverage of internal control to include the effect of information technology (IT) on the audit and reviews the tools available to the auditor for auditing in an IT environment.

Part IV: Audit Testing

This part of the text introduces and develops the concepts of audit testing. The first part of Chapter 8 covers audit sampling for tests of controls, followed by a discussion of audit sampling for substantive tests of balances. The coverage is conceptual and focuses on the logical sequence of steps in each application of audit sampling. Illustrations of statistical sampling are presented in the Online Learning Centre website (www.mcgrawhill.ca/college/messier). The material covers statistical sampling for attributes (i.e., for tests of controls) and statistical sampling for variables (i.e., for substantive tests of balances). It also presents the use of computer software for statistical sampling applications.

Part V: Auditing Business Processes

Part V describes the application of internal control concepts and evidence-gathering procedures to various business processes. The EarthWear Clothiers case is used to present these business processes. Chapters 9 to 15 discuss key business processes and inherent risk considerations, the assessment of control risk, and substantive testing for each business process and its related account balances.

Part VI: Completing the Audit and Reporting Responsibilities

Part VI focuses on the steps followed at the end of the audit and provides expanded coverage of audit reporting. Chapter 16 discusses contingent liabilities, commitments, and subsequent events, and also describes the final evidence evaluation process followed by the auditor. Chapter 17 presents the details of audit reporting and covers a number of special reporting issues, including the various types of audit report reservations.
Part VII: Professional Responsibilities

Part VII is devoted to the auditor’s professional responsibilities. Chapter 18 reviews the new Ontario Securities Commission and Securities and Exchange Commission rules on independence, as well as the new CICA rules on independence. It also covers ethics, professional conduct, and quality control standards. Chapter 19 discusses the legal environment that confronts the auditing profession.

Part VIII: Accounting Services, Attest Engagements, and Assurance Services

Part VIII covers assurance services, including the demand for such services. Chapter 20 begins with the traditional and progresses to the new. It first discusses accounting and review services, two accounting services commonly provided by practitioners to their clients. It then describes a number of attest services, including audit reports on subsets of financial information and on future oriented financial information, and the auditor’s involvement in prospectuses. Chapter 20 finishes with more detailed discussion and examples of the new assurance services introduced in Chapter 1.

Elements of this Textbook

In-Text Features

- At the beginning of each chapter, there is a list of detailed learning objectives, which are referenced throughout the text, to help you understand the concepts of the chapter. [LO 1]

- Right beside the learning objectives, there is a handy list of relevant accounting and auditing pronouncements, tailored for the Canadian audience.

Integrated Cases

This text contains an integrated case, EarthWear Clothiers, which is introduced in Chapter 1. This case is based on a real-world company and is used to demonstrate important auditing concepts throughout the book. The Online Learning Centre website (www.mcgrawhill.ca/college/messier) contains extensive financial and other information on EarthWear, and a link to the website for the company’s auditors, which also contains selected working papers from this year’s audit of EarthWear. There are also numerous problems and Internet assignments related to EarthWear throughout the text, highlighted using the EarthWear logo. Besides the EarthWear case, the Calabro Paging Services case is included as a discussion problem in Chapter 3. It is also used in various chapters to demonstrate important concepts with an alternative industry. A number of problems in the book are based on the Calabro case.
End-of-Chapter Material

- **Review questions** enable students to quickly test their knowledge of that chapter’s learning objectives.
- **Multiple-choice questions** drawn from professional examinations help students to quickly review and summarize the chapter concepts.
- Detailed **problems** use higher learning skills such as analysis, judgment, and decision making to test students’ abilities when faced with specific facts and scenarios.
- **Discussion cases** expand student learning by providing a detailed audit scenario and requiring an understanding and synthesis of the chapter concepts. Many of the discussion cases were developed from real-world examples and require students to research the answers using various information sources.
- **Internet assignments** return students to the EarthWear Clothiers case, asking them to gather various types of accounting and industry information.

Distinguishing Features of the Second Canadian Edition

The Second Canadian edition of *Auditing & Assurance Services: A Systematic Approach* has a number of important features:

- Care has been taken to ensure that the material reflects the Canadian environment, and current Canadian standards and practice. For example, in the introductory chapter, the student is introduced to the different Canadian professional bodies and to generally accepted auditing standards as set out in the CICA *Handbook*, the authoritative source of auditing standards in Canada. This perspective is maintained throughout the text.
- The text takes a systematic approach to the audit process by building on the basic concepts of materiality, audit risk, and audit evidence.
- The text introduces the Strategic Systems Approach to auditing, an audit process that relies on understanding the entity, its business processes, and its environment to identify business risks that may result in material misstatements in the financial statements.
- A business processes approach is followed, with the components of the audit risk model addressed in each business process chapter.
- The discussion of internal control in each business process assumes some level of computerization. As a result, the effect of computer processing on the audit is introduced immediately after, and as an
extension of, the consideration of internal control. The use of IT audit techniques is presented as a part of the discussion of auditing each business process and account balance.

- The coverage of legal liability in Chapter 19 has been updated to reflect recent events related to companies such as Enron and WorldCom. The chapter stresses the current Canadian legal environment and provides numerous examples of important Canadian legal precedent cases. In recognition of the fact that our legal environment has been and continues to be influenced by other jurisdictions, reference is made to important legal cases in both the UK and US, but the emphasis is on the current Canadian environment.

- The end-of-chapter materials contain review questions, multiple-choice questions, problems, and discussion cases from a variety of sources. Multiple-choice questions have long been a standard component of the CPA examinations in the US and as a result the AICPA has an extensive data bank of such questions. The multiple-choice questions are mostly drawn from that source, appropriately adapted to fit the Canadian context and supplemented or replaced by questions from other sources such as the Certified General Accountants Association of Canada. The problems and discussion cases are drawn from CICA Uniform Final Examinations, CGA-Canada National Examinations, provincial Institute of Chartered Accountants examinations, CPA and CIA examinations, and from problems developed by the authors. In addition, three comprehensive auditing questions adapted from past CICA Uniform Final Examination Comprehensive examination questions have been added to the text’s website. Canadian-sourced problems and discussion cases were included, not just to add Canadian content, but to provide students with an opportunity to test themselves with the kind of questions they will confront if they pursue a professional accounting career in Canada.
Technology Solutions

Online Learning Centre

More and more students are studying online. That is why we offer an Online Learning Centre (OLC) that follows *Auditing & Assurance Services* chapter by chapter. You don’t have to build or maintain anything and it’s ready to go the moment you and your students type in the URL:

www.mcgrawhill.ca/college/messier

As your students study, they can refer to the OLC website for such benefits as:

- Learning objectives
- A link to the website of EarthWear’s auditor Willis & Adams (featuring a full set of working papers for EarthWear)
- Bonus chapter material
- True/false quizzes
- Multiple-choice questions
- Internet assignments

Remember, the *Auditing & Assurance Services* OLC content is flexible enough to use with any course management platform currently available. If your department or school is already using a platform, we can help. For information on our course management services, contact your i-Learning Sales Specialist.
Superior Service

Service takes on a whole new meaning with McGraw-Hill Ryerson and Auditing and Assurance Services: A Systematic Approach. More than just bringing you the textbook, we have consistently raised the bar in terms of innovation and educational research—both in finance and in education in general. These investments in learning and the education community have helped us to understand the needs of students and educators across the country, and allowed us to foster the growth of truly innovative, integrated learning.

Your Integrated Learning Sales Specialist is a McGraw-Hill Ryerson representative who has the experience, product knowledge, training, and support to help you assess and integrate any of the below-noted products, technology, and services into your course for optimum teaching and learning performance. Whether it’s using our test bank software, helping your students improve their grades, or putting your entire course online, your i-Learning Sales Specialist is there to help you do it. Contact your local i-Learning Sales Specialist today to learn how to maximize all of McGraw-Hill Ryerson’s resources!

McGraw-Hill Ryerson offers a unique i-Services package designed for Canadian faculty. Our mission is to equip providers of higher education with superior tools and resources required for excellence in teaching. For additional information visit www.mcgrawhill.ca/highereducation/eservices/

Teaching, Technology & Learning Conference Series

The educational environment has changed tremendously in recent years, and McGraw-Hill Ryerson continues to be committed to helping you acquire the skills you need to succeed in this new milieu. Our innovative Teaching, Technology & Learning Conference Series brings faculty together from across Canada with 3M Teaching Excellence award winners to share teaching and learning best practices in a collaborative and stimulating environment. Preconference workshops on general topics, such as teaching large classes and technology integration, will also be offered. We will also work with you at your own institution to customize workshops that best suit the needs of your faculty.
Supplements
For the Instructor

Instructor's Online Learning Centre  The OLC includes a password-protected website for Instructors; visit us at www.mcgrawhill.ca/college/messier. The site offers downloadable supplements and PageOut, the McGraw-Hill Ryerson course website development centre.

Instructor's CD-ROM  The following instructor supplements are available on the Instructor's Supplement CD-ROM, and most are downloadable from the Online Learning Centre:

- **Solutions Manual**, containing thorough up-to-date solutions to the book's end-of-chapter material, is also available from the OLC.
- **Computerized Test Bank**, including additional multiple-choice questions adapted from professional examinations. Professors may use this software to create, edit, and print a variety of tests.
- **PowerPoint® Presentation** to support and organize lectures.

PowerWeb

Keeping your course current can be a job in itself and now McGraw-Hill Ryerson can do it for you. PowerWeb extends the learning experience beyond the core textbook by offering all the latest news and developments pertinent to your course via the Internet, without all the clutter and dead links of a typical online search.

PowerWeb offers current articles related to auditing and accounting, weekly updates with assessment tools, informative and timely world news culled by an auditing expert, refereed web links, and more. Students may also access study tips, conduct online research, and learn about different career paths. Visit the PowerWeb site at www.dushkin.com/powerweb and see firsthand what PowerWeb can mean to your course.

Course Management

PageOut  McGraw-Hill Ryerson’s course management system, PageOut, is the easiest way to create a website for your auditing and assurance course. There is no need for HTML coding, graphic design, or a thick how-to book. Just fill in a series of boxes in plain English and click on one of our professional designs. In no time, your course is online!

For the integrated instructor, we offer *Auditing & Assurance Services* content for complete online courses. Whatever your needs, you can customize the *Auditing & Assurance Services* Online Learning Centre content and author your own online course materials. It is entirely up to you. You can offer online discussion and message boards that will complement your office hours and reduce the lines outside your door. Content cartridges are also available for course management systems, such as WebCT and Blackboard. Ask your i-Learning Sales Specialist for details.
For the Students

Student Online Learning Centre  The OLC offers aids such as online quizzes, Internet assignments, and more! The Auditing & Assurance Services Online Learning Centre is located at www.mcgrawhill.ca/college/messier.

Acknowledgments and Development Focus

Craig Emby would like to acknowledge the Canadian Institute of Chartered Accountants for permission to quote from the CICA Handbook and the Uniform Final Examination; the Certified General Accountants Association of Canada for permission to quote from auditing examinations; the CGA-Canada for permission to extract from AUDITING 1 and AUDITING 2 Examinations published by the Certified General Accountants Association of Canada (©CGA-Canada, 2000, 2001, and 2002); the Institute of Chartered Accountants of British Columbia and the Institute of Chartered Accountants of Ontario for permission to quote from auditing examinations; and the American Institute of Certified Public Accountants for permission to quote from the Uniform CPA Examination and the Journal of Accountancy. Bill Messier would also like to thank ACL Services Ltd. for granting permission to use ACL for Windows, the online statistical sampling material.

Extensive feedback from our market research, including surveys and reviews, and the valuable suggestions provided by that process helped us develop and enhance this product. Thank you to the following colleagues for their invaluable advice: Merridee Bujaki, University of Ottawa; Peggy Ann Coady, Memorial University; Ian Feltmate, Acadia University; Margery Heuser, Okanagan University College; Michael Malkoun, St. Clair College; Janet Morrill, University of Manitoba; Jennifer Nicholson, Saint Mary’s University; Keri Norrie, Camosun College—Interurban Campus; Bryan K. Parker, British Columbia Institute of Technology; Jagdish Pathak, University of Windsor; Clifton Philpott, Kwantlen University College; Sandra Robinson, Concordia University; Steve Salterio, Queen’s University; Dan A. Simunic, University of British Columbia; and Glenys Sylvestre, University of Regina.

Craig Emby would also like to thank the editorial and production staff at McGraw-Hill Ryerson—Hope Miller, Tom Gale, Rhond da McNabb, Margaret Henderson, Erin Moore, and Michelle Losier—for their patience and assistance in the preparation of this book.

William F. Messier, Jr.
Craig E. N. Emby