

## ACCOUNTING 407 AUDITING

Spring 2004

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*Note: Application has been made for certain sections of ACCT 407 to satisfy the University's graduation requirement as a "writing intensive" course*

### The Wehner Building

*"We have beautiful, state-of-the-art classrooms in the Wehner Building. We want to maintain the outstanding quality condition of these classrooms for current and future students. Thus, it is necessary for you to adhere to the firm policy of **no beverages, food, tobacco products, or like items within the Wehner classrooms**. Your understanding of the necessity for this policy and cooperation will be greatly appreciated. This policy will be strictly enforced. If you have a special condition that requires the intake of water during the class period, please see me. In this circumstance, an exception will be granted."*

### Students with disabilities

The Americans with Disabilities ACT (ADA) is a federal anti-discrimination statute that provides comprehensive civil rights protection for persons with disabilities. Among other things, this legislation requires that all students with disabilities be guaranteed a learning environment that provides for reasonable accommodation of their disabilities. If you believe you have a disability requiring an accommodation, please contact the Department of Student Life in 126 Koldus or call 845-1637.

### Academic Dishonesty

Disciplinary action will be taken in cases of academic dishonesty. It is the responsibility of students and instructors to help maintain scholastic integrity at the university by refusing to participate in or tolerate scholastic dishonesty. Every act of academic dishonesty deflates the value of the TAMU degree you hope to receive. Examples of scholastic dishonesty include 1) acquiring answers for any assigned work or examination from any unauthorized source, 2) observing the work of other students during any examination, 3) providing answers for any assigned work or examination when not specifically authorized to do so, 4) failing to credit sources used in a work

product in an attempt to pass off the work as your own, 5) attempting to receive credit for work performed by another, including papers obtained in whole or in part from individuals or other sources, and 6) fabrication of information. For more information, see TAMU Student Rules (<http://student-rules.tamu.edu/part1.htm>)

### **Readings and References**

Text: Auditing Theory and Practices, Hermanson, Strawser, and Strawser; Latest edition.

AICPA Website: <http://www.aicpa.org/assurance>

### **Fraud in a Financial Statement Audit: What Every Auditing Student Should Know About SAS No. 99**

[http://www.aicpa.org/antifraud/educators\\_students/Understanding\\_SAS99/Rrequirements\\_of\\_SAS99\\_edupkg\\_classroom\\_use/92.htm](http://www.aicpa.org/antifraud/educators_students/Understanding_SAS99/Rrequirements_of_SAS99_edupkg_classroom_use/92.htm)

TAMU Writing Center: <http://uwc.tamu.edu>

The Writing Center website contains links to a wealth of information. Students should explore *Webliography* for various writing aids.

Learning Aids (see page 8 of this syllabus)

In addition to the above, there will be various handouts during the semester including the following:

- AICPA Plain English Guide to Independence, June 15, 2003.
- Knechel's Chapter 5 "Understanding the Client's Business: Strategic Analysis"
- Three cases on fraud, internal control and audit reports (TBA)

### **OBJECTIVES**

To prepare students for a very profound and socially responsible profession.

To facilitate the development of professional judgment in materiality and risk assessment, in ethical conduct, in the application of generally accepted auditing standards, in **transmitting written information**, and in the determination of sufficient competent evidential matter for the purpose of rendering a professional opinion on financial statements or any other assertions made by management.

To convince you that the development of oral and written communication skills and problem solving abilities (which emphasize rational and logical solutions developed individually or in a group) are essential for success in public accounting, as well as in many other professions. Much of the technical material that you learn in this class will be obsolete in 5 to 10 years, so it is important that you learn how to learn new material rather than memorizing. **You are encouraged to think rather than memorize. Ambiguity is King!**

To expose students to the degree of skill and knowledge required to obtain the CPA license. This license is a measure of **minimum** excellence, nothing more.

In addition, each chapter has a list of learning objectives with which you should become thoroughly familiar. By the end of the semester you should be able to:

- Understand the Code of professional conduct as it specifically relates to the auditor's financial and managerial independence from the client it represents.
- Understand that business viability and profitability assessments are essential elements of financial statement auditing. In obtaining this understanding you will learn that a company's viability and profitability are functions of numerous business processes and interdependencies both internal and external to the company.
- Identify major deficiencies in an unqualified, qualified, adverse, or a disclaimer audit report.
- Identify internal control strengths and weaknesses (and how to correct such deficiencies) in a typical business environment and how such controls affect assessment of audit risk.
- Professional skepticism has always played an important part in the planning and execution of an audit. Post Enron, a CPA's "due professional care" has taken a front row seat in the minds of regulators, investors, and the general public. Therefore, in this course additional emphasis will be placed on your understanding of the auditor's responsibility for detecting fraud in a financial statement audit.
- Write a generic audit program for testing specific internal controls and performing specific substantive tests for the purpose of verifying any or all of management assertions.
- Identify and understand the nature of the auditor's legal liability under statutory law and common law.
- **Communicating, whether through oral, visual or written means, is necessary. Clear instructions must be communicated to staff, persuasive arguments must be made to clients, clear documentation must be present in working papers and unambiguous wording must be present in engagement letters and contracts.**

**Your ability to perform all of the above will be tested on examinations and in a number of reports that are submitted during the term.**

### **CLASS ETIQUETTE**

The fall is always an extremely busy time for students. There are always extracurricular activities including sports and, of course, the greatest sporting challenge of all, finding a job. I am almost positive that missing classes because of any of the above do not fall under University excused absences. However, if you have a job interview that conflicts with a scheduled exam and your potential employer is not sympathetic, please see me ASAP. Please note that this applies to exams and not to assignments. Except for University absences, no allowances will be made for missed assignments.

In addition, some of you are taking a full load this fall and have a full time job. Although there are other demands on your time, each class day is extremely important. While your daily attendance is not mandatory, it is vital to your success in this class. Information is often provided that is not in the text. As a result, you will be responsible for all material covered in class and for any changes in the syllabus whether you grace us with your presence or not.

Promptness is expected. However, the instructor can be 5 minutes late. Any avoidable late interruptions are both rude and unprofessional.

You are expected to read the chapters before the appropriate class period. No Joke!

The due dates for the projects and exams are **not** flexible. You are, therefore, encouraged to **plan ahead!!**

### **EXAMS (400pts)**

There will be 2 exams plus a final. The exams will be multiple-choice and essay. The final exam will be **CUMULATIVE**. Make-up exams will only be given for University excused absences. **Each of the exams will contain a graded writing component representing 20% of the examination. These written exercises will be graded on the basis of their clarity and style that is suitable in the workplace.**

### **CASES (75 pts)**

There will be 5 group cases. Each case is worth 25 points. Cases will be provided at least two weeks in advance of their due dates. **The cases will require a high degree of concentration on the ability to communicate clearly to the assumed audience. Since this is**

a writing-intensive course, class time will be devoted to feedback so the quality of the final submission meets professional standards. Your writing will be evaluated, in part, for grammatical correctness, but more emphasis will be placed on the clarity and persuasiveness of your writing. Your ability to communicate will be judged on how persuasively your narrative can influence a manager who reviews your work and whether it would be clearly understood by the client.

Examples of writing assignments from past groups are available in my office for your review and discussion.

You will be assigned a number of individual short writing assignments related to your case assignment to help assure that everyone is working at the same pace and making individual, positive contributions to the case solution. These "vignettes" will be turned in and randomly chosen for review and feedback.

**Restaurant Project (DUE March 11<sup>th</sup> )**. Each group should select a local eating establishment (fast food places are not acceptable). This should be done no later than February 3<sup>rd</sup> . Each group should post their selection on the web board. Put your section number, group number, and restaurant choice in the subject line. Once posted, no other group will be allowed to use that group's selection. In other words, "first come, first served." Please check the web boards to determine which restaurants have been chosen.  
**MY APPROVAL IS REQUIRED.**

After you have made your choice your group should identify at least four control strengths and four control weaknesses that may exist in the restaurant's observable operations. You should focus your attention only on those strengths and weaknesses that any ordinary customer might observe. The lack of pre-numbered tickets and the location of entrances/exits that may facilitate non-payment would be good examples of strengths/weaknesses you might find. You may ask the restaurant's personnel but this is **not required**.

**The final written report should contain the following:** For each control procedure you identify, please indicate at least three ways an auditor could test the effectiveness of the control. For each weakness you identify, please indicate at least one potential effect on the restaurant's operations. Your answers should be organized as shown below. You should incorporate the terminology in chapters 4, 5, and 6 of the Strawser text. For example, when describing a control (strength or weakness) you should identify it as one or more of the controls discussed in the chapters. In addition, when describing the tests of controls you should identify the type of audit procedures you would use and the accounting files/documents you would examine. The various management assertions verified by the test or impacted by the control weakness should also be addressed.

The cases and projects are performed in a working group, which is common in auditing. When a report is due, work is often divided between the group members wherein one person is assigned a specific part of the final report. When this is done, a problem is often created. A reader can usually tell that the writing style of each person varies and that the report has been written by different people. **IT IS IMPORTANT THAT SOME GROUP MEMBERS EDIT THE ENTIRE DOCUMENT SO THAT THE "FLOW" DOES NOT CHANGE FROM ONE PART OF THE PAPER TO THE NEXT AND THAT CONCLUSIONS REACHED ARE NOT INCONGRUOUS WITH THE DIFFERENT PARTS OF THE REPORT.**

### **Video Presentations (50 pts)**

You will see a series of videos during the semester. The videos describe the importance of the audit as seen through the eyes of the various stakeholders. **For each video, you are individually required to write a brief report of any single issue from the video which you deem important to a client. The report should be written in a style that addresses a client's concern and follows with your response of how an audit will alleviate that concern. The quality of the writing is paramount.**

The final video, "CableCo", is a visual presentation of what the audit process is really like and an attempt to show you what you have learned throughout the semester. This video chronicles the audit process from the initial acquisition of the client, to the planning of the audit, performing tests of transactions/balances, and to the issuance of the audit report.

And no, you cannot bring popcorn!

### **Class Participation (75 pts)**

Preparation for each class and active participation in our discussions is expected. Thinking on your feet is part of the learning process. Just sitting on your anatomy is not. It is important that you share your insights, your perspective and understanding of the topics discussed. Sharing your ideas in a forum is critical not only for your self-development and self-confidence but it also facilitates the learning process for everyone in the classroom, including me. Because class participation is a key element in this course, I will evaluate each student's participation in the class discussion as outlined further below.

Acknowledging that you do not understand an issue or concept is not your failure but mine for not providing you with an adequate explanation. Please ask me any and all clarifying questions you think are necessary for you to understand the issue(s).

I cannot adequately keep track of comments made by each and every student. If I did, it would probably be very distracting. As a result, I have developed the following system. If

**you believe** you have *significantly* added to the class discussion by asking and answering questions on *point*, I am requesting that you write your name and the date on a small slip of paper. Please turn this information in at the end of each class period. I will keep track of these participation slips and allocate the class participation points accordingly. **Please wait until the end of the class period to start tearing off the pieces of paper to turn in.** Past experience suggests that the cumulative noise can be very distracting and gives the obvious impression that you do not plan on saying anything else for the rest of the period.

These 75 points represent approximately 11.5 % of your total grade. Failure to participate, and hence, the failure to cumulate the 75 points, could mean the difference between the grade you get and the grade you believe you deserve. If you have not put forth the effort in class, please do not ask me to “give” you these participation points. I will not. Zero slips equate to zero points!!!

If you believe that this point system is potentially unfair to you (whatever the reason), you should see me ASAP. Do not wait until the semester is almost over.

### **Check points and end of the chapter problems (zero pts)**

Problems, including the entire chapter check points are assigned for each chapter. Although these problems will not be collected, they should be completed to facilitate preparation for each exam. Copies of the solutions for the end of the chapter problems will be made available during each week of class. **WARNING: Do not** memorize the suggested answers. You will be wasting precious time. **Do not** look at the solution prior to attempting the homework problem; you will **not** get the maximum benefit. **Do not** automatically assume that the solution is correct and that your answer is incorrect; publishers and authors can and do make mistakes. Please see me for any and all clarifications.

### **TOTAL POINTS AVAILABLE:**

Your grade in this course will be based on the following:

First Exam	100
Second Exam	100
Final Exam	200
Restaurant Project	50
Videos	50
Cases	75
Class Participation	<u>75</u>
Total points	<u>650</u>

**Writing content: 255 points (out of 650) depend on writing assignments.**

Grades will be assigned based on the standard scale as indicated below:

A	>650*.9
B	>650*.8< A
C	>650*.7< B
D	>650*.6<C
F	< D

### **Learning Aids**

The following handouts are available on my web page. These handouts serve to summarize some of the course content. They are not provided as substitutes for reading the assigned material but merely to facilitate your overall understanding.

1. Abridged course notes.
2. Summary of issues surrounding auditor's legal liability.
3. Summary of departures from standard audit report.
4. Summary of understanding of internal controls required to plan the audit.
5. Summary of examples of select management assertions matched with control procedures.
6. Summary of assertions matched with substantive tests for certain balance sheet accounts.
7. Simplistic audit program for accounts receivable.
8. Summary of key issues in the audit of information systems.
9. Link to the TAMU Writing Center.

### **Some Myths and Realities about Learning Auditing**

**Myth 1: "I read the chapters and do all of the assignments but my grade doesn't show what I have learned."**

Reality 1: Reading the chapters and doing the homework provide a minimum understanding and therefore a minimum grade. Above average grades require additional work.

**Myth 2: "I did learn a lot from the projects, but I wasted a lot of time just trying to figure out exactly what I was doing."**

Reality 2: It may have taken a lot of time, but that time was not wasted. You were thinking, and you learned more than you would have if you were told exactly what to do.

**Myth 3: "Unless a student has the opportunity to spend time with other students in the class discussing their interpretations of the assignments, he or she may be left out in the cold."**

Reality 3: There is insufficient class time to discuss all topics in depth. Out of class discussions of concepts and interpretations are encouraged. Where out of class assignments are involved everyone should do their own thinking and submit their own work.

**Myth 4: "In doing the cases and projects there should be more guidance because it is frustrating to try and complete something by a deadline when you really don't know what you are doing."**

Reality 4: In the future you will always have a deadline and you will seldom know exactly how to do what you have been assigned to do. As soon as you master one task, you will be assigned another unfamiliar one (with a deadline).

**Myth 5: "I didn't miss one day of class and still feel like I have not accomplished anything."**

Reality 5: Merely showing up for class provides no assurance of accomplishment. Preparation and active class participation are necessary.

**Myth 6: "Increase the guidance given on the cases and project so that you can concentrate on learning 'how to' instead of worrying if you have done what you are supposed to."**

Reality 6: The most important thing you can learn in this course is how to identify problems. In the future they will not be identified for you. Determining how to deal with a problem is usually simple once the problem has been identified.

Author Unknown

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<b>DATE</b>	<b>DISCUSSION TOPIC</b>	<b>READING ASSIGNMENT</b> -Do not read appendices unless otherwise instructed-	<b>HOMEWORK PROBS.</b> <b>PROJECTS</b>
January 20 Tuesday	Introduction to the audit environment  Professional Code	Chapter 1 Skim  Chapter 2	None
January 22 Thursday	<b>The importance of writing in auditing</b>		
January 27 Tuesday	Professional Code: Independence, Confidentiality	Chapter 2	<b>Chapter 2--All Mcs and chapter ck pts and chapter ck pts</b> Problems: 2-28, 2-29,2-30, 2-31
January 29 Thursday	Professional Code: Independence, Confidentiality	Chapter 2 ---Continued---	---Continued---
February 3 Tuesday	Audit Reports	Chapter 17	<b>Chapter 17-- All Mcs and chapter ck pts</b> Problems:17-25,17-26, 17-27,17-29,17-40
February 5 Thursday	Audit Reports	Chapter 18 (Skim pgs 18-1 thru 18-7 and 18-20 thru18-27. Read remainder.)	<b>Chapter 18—All Mcs and chapter ck pts</b> Problems:18-28,18-30
February 10 Tuesday	Audit Reports	Chapter 18 --continued--	<b>Chapter 18—Continued</b>
February 12 Thursday	Audit Reports	Chapter 19 (Read pages 19-16 thru 19-26 only)	<b>Chapter 19--All Mcs and chapter ck pts related to the assigned pages</b> Problems: 19-36 thru 19-40 <b>Group case 1 due</b>

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February 17 Tuesday	Exam 1	Exam 1	Exam 1
February 19 Thursday	Engagement Planning, Strategic Analysis, and Risk Assessment Internal controls for revenues, receivable, and cash receipts	Chapter 4 Knechel's Chapter 5 (copies provided) Chapters 5 and 6	Chapter 4-- <b>All Mcs and chapter ck pts</b> Problems:4-30,4-32,4-33, 4-34  Knechel (#2,#3,#4)  Chapters 5&6: <b>All Mcs and chapter ck pts</b> Problems: 5-33,5-34,5-35,5-36,5-37,5-38,5-39, 5-40,5-41 6-31,6-32,6-34,6-36
February 24 Tuesday	Internal controls for revenues, receivable, and cash receipts. <b>Engagement letter due</b>	Chapters 5 and 6	Chapters 5&6: <b>All Mcs and chapter ck pts</b> Problems: 5-33,5-34,5-35,5-36,5-37,5-38,5-39, 5-40,5-41 6-31,6-32,6-34,6-36
February 26 Thursday	Internal controls for revenues, receivable, and cash receipts	Chapters 5 and 6	Chapters 5&6: <b>All Mcs and chapter ck pts</b> Problems: 5-33,5-34,5-35,5-36,5-37,5-38,5-39, 5-40,5-41 6-31,6-32,6-34,6-36
March 2 Tuesday	Internal controls for revenues, receivable, and cash receipts. <b>First submission of restaurant project due</b>	Chapters 5 and 6	Chapters 5&6: <b>All Mcs and chapter ck pts</b> Problems: 5-33,5-34,5-35,5-36,5-37,5-38,5-39, 5-40,5-41 6-31,6-32,6-34,6-36
March 4 Thursday	Internal controls for revenues, receivable, and cash receipts	Chapter 10 Revenue Cycle	Chapter 10-- <b>All Mcs and chapter ck pts</b> Problems 10-26,10-27, 10-30,10-33,10-34 <b>Group case 2 due</b>
March 9 Tuesday	Internal controls for revenues, receivable, and cash receipts	---continued--	---continued---

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March 11 Thursday	Internal controls for expenses, payables, and cash disbursements	Chapter 12 Payment Cycle	Chapter 12-- <b>All Mcs and chapter ck pts</b> Problems:12-24,12-27, 12-30,12-32 <b>Restaurant Project Due</b>
March 23 Tuesday	Substantive test: Cash, receivables, and inventory	Chapter 11	Chapter 11-- <b>All Mcs and chapter ck pts</b> Problems:11-30,11-31, 11-33,11-39,11-40
March 25 Thursday	Substantive test: Cash, receivables, and inventory	---continued---	---continued---
March 30 Tuesday	Exam 2	Exam 2	Exam 2
April 1 Thursday	Substantive test: Cash, receivables, and inventory	Chapter 11	.....Continued....
April 6 Tuesday	Substantive test: Cash, receivables, and inventory	Chapter 13 (Pages 13-1 thru13-17)	Chapter 13-- <b>All Mcs and chapter ck pts</b> Problems:13-30(a),13-31,13-32,13-33,13-34, 13-36 <b>Group case 3 due</b>
April 8 Thursday	Substantive test: PP&E, securities, LTD, and equity	Chapter 15	Chapters 15 -- <b>All Mcs and chapter ck pts</b> Problems:15-29,15-34, 15-37
April 13 Tuesday	Substantive test: payables Completion of the Audit: Subsequent events and representation letters	Chapter 16	Chapters 16 -- <b>All Mcs and chapter ck pts</b> Problems:16-26,16-27, 16-29
April 15 Thursday	SEC Reporting Auditor's legal liability	Chapter 3 Handout on SEC reporting	Chapter 3-- <b>All Mcs and chapter ck pts</b> Problems: To be assigned
April 20 Tuesday	SEC Reporting Auditor's legal liability --continued---	--continued--	--continued--  <b>Group case 4 due</b>
April 22 Thursday	SEC Reporting Auditor's legal liability --continued---	--continued--	--continued--  <b>Group case 5 due</b>

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April 27 Tuesday	Video	Questions to be provided	
April 29 Thursday	Guess Speaker		
May 7 Friday	3-5 p.m. Final exam		