**Chapter 1**

**The Demand for Audit and Other Assurance Services**

Usually students will not have read Chapter 1 before the material is covered. As a policy, we always give students the entire scheduled time on the first day of class. In addition to setting up a seating chart (which we always use), and reviewing the course policies and procedures, we attempt to cover the following major topics in the chapter:

* Chapter Opening Vignette
* Nature of Auditing
* Distinction between auditing and accounting
* Economic demand for auditing
* Overview of assurance services
* Types of audits and auditors
* Requirements for becoming a certified public accountant

**Chapter Opening Vignette — “Brown Goes Green”**

We use this vignette about the United Parcel Service (UPS) sustainability reporting to highlight the role of auditors in providing assurance on sustainability reports, as well as many other types of information. Students have a great interest in sustainability, but most are not familiar with sustainability reporting and assurance. This is a great way to gain students’ interest by emphasizing the valuable role of auditors in providing assurance on all types of information. Consider assigning Problem 1-24, if you would like to expose students further to sustainability reporting.

**Nature of Auditing** (page 4)

Start by asking students to tell you what auditing is and display one of the student’s own definitions. Other students are asked to discuss it until there is a reasonably usable definition. The three things that should be stressed are:

1. Evidence (define the term)
2. Information
3. Determining degree of correspondence

Students tend to think of auditing as auditing financial statements by CPA firms in accordance with GAAS or other auditing standards. We therefore use **Figure 1-1** on page 5, to discuss the definition.

**(See Figure 1-1; shown on Slide 1-7)**

We also like to display the matrix on **OH-1-1** and go through it with the students. As a part of this, students are briefly introduced to IRS auditors, CPAs, and internal auditors. None of this is usually lecture.

**(See OH-1-1)**

After you have gone over this information, refer students to the definition of auditing as included on **Slide 1-5**.

**(See Slide 1-5)**

Briefly talk about the importance of:

 Competence and independence of auditor (Chapter 4)

 Need to report on findings (Chapters 3, 24, and 25)

**Distinction between Auditing and Accounting** (page 6)

We spend little time on the distinction between accounting and auditing, but it is at least desirable to point out the differences and relationship between the two. Then ask why auditors need to have knowledge of accounting to be effective auditors. See Review Question 1-2.

**Economic Demand for Auditing** (page 6)

We like to spend a few minutes discussing the economic role of auditors in society in Chapter 1. Refer back to this material again in Chapter 5 (legal liability) and Chapter 8 (audit planning and materiality).

First, go over the three factors determining interest rates, with emphasis on information risk. Use **OH-1-2** to summarize the material in the text. It is useful to discuss the effect on earnings of reducing an organization’s interest rate by 1 or 2%. Problem 1-17 is useful for demonstrating the level of assurance associated with audits and reviews, and the effect of these services on information risk and borrowing costs.

**(See OH-1-2)**

**Assurance Services** (page 8)

We start by asking students to describe assurance services. The term will be unfamiliar to most students, but some may recognize the concept. We discuss the following services:

 Assurance services

 Attestation services

 Audits of historical financial statements

 Audits of internal control over financial reporting

 Reviews of historical financial statements

 Management consulting and other nonassurance services

We then cover Problem 1-16 in class to help students distinguish assurance, attestation, and audit services.

Ask students to suggest other types of information on which users may desire assurance and the most likely provider of the assurance. **OH-1-3** can be used to list their responses. To start the discussion, we often name one or two types of assurance that aren’t provided by CPAs, such as gas pump inspections and Arbitron radio ratings. Ask students to suggest reasons why the demand for assurance is increasing. **Table 1-1** (page 11) is helpful for identifying other types of assurance services that may be provided by CPAs.

**(See OH-1-3)**

**(See Table 1-1; shown on Slide 1-23)**

Problem 1-18 can be covered in class to give students a perspective on the similarity between assurance services offered by CPAs and the role played by organizations such as Consumers Union.

**Types of Audits and Auditors** (page 12, page 14)

Most students at our universities know little about the types of auditors and the nature of CPA firms. In a brief discussion, we highlight the following for the students:

 The nature of financial, operational, and compliance audits

 The primary differences between independent CPAs, government auditors, internal revenue agents, and internal auditors

**OH-1-1** and **Table 1-2** (page 12) can be used as part of this discussion. Problem 1-20 is a good one to use in class as part of a discussion about careers in accounting. Problem 1-21 can also be used to help distinguish the types of audits, and the auditor most likely to perform the audit.

**(See OH-1-1)**

**(See Table 1-2; shown on Slide 1-26)**

**Certified Public Accountant** (page 16)

We talk briefly about why some people want to be a CPA. We use **Figure 1-3** (page 16) to review the requirements for becoming a CPA, and also discuss the exam requirements and the format of the computerized exam.

**(See Figure 1-3; shown on Slide 1-33)**

We then review the CPA Exam eligibility requirements in our state. We encourage students to visit the CPA Examination portion of the AICPA website (www.aicpa.org) to learn more about the exam and to review the link to Frequently Asked Questions (FAQs) about the CPA Exam. We find students appreciate this information and it saves us a lot of time in the office telling them the same thing individually. Problem 1-25 requires students to research different requirements of the CPA Exam.

**CHAPTER 1**

1-5

**CROSS-REFERENCE OF LEARNING OBJECTIVES AND PROBLEM MATERIAL**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **LEARNING OBJECTIVES** | **CONCEPT CHECKS** | **REVIEW QUESTIONS** | **MULTIPLE CHOICE QUESTIONS** | **DISCUSSION QUESTIONS AND PROBLEMS** | **CASES** |
| **1-1**  Describe auditing. | P. 8, 1 | 1-1, 1-9 | 1-13 | 1-19 |  |
| **1-2** Distinguish between auditing and accounting. |  | 1-2 |  |  |  |
| **1-3** Explain the importance of auditing in reducing information risk. |  | 1-3, 1-4 | 1-13 | 1-17, 1-18,  1-22 |  |
| **1-4** List the causes of information risk, and explain how this risk may be reduced. | P. 8, 2 | 1-5, 1-6 |  | 1-18 |  |
| **1-5** Describe assurance services and distinguish audit services from other assurance and nonassurance services provided by CPAs. |  | 1-7, 1-8,  1-11 | 1-13, 1-15 | 1-16, 1-18,  1-22, 1-23,  1-24 |  |
| **1-6** Differentiate the three main types of audits. | P. 16, 1 | 1-10, 1-11 | 1-14, 1-15 | 1-21 |  |
| **1-7** Identify the primary types of auditors. | P. 16, 2 | 1-9, 1-10 | 1-14 | 1-20, 1-21 |  |
| **1-8** Describe the requirements for becoming a CPA. |  | 1-12 |  | 1-25 |  |

**INFORMATION BEING AUDITED,  
TYPE OF AUDITOR, CRITERIA,  
AND NATURE OF EVIDENCE**

|  |  |  |  |
| --- | --- | --- | --- |
| **INFORMA-TION BEING AUDITED** | **WHO PERFORMS THE AUDIT** | **CRITERIA TO DETERMINE CORRE-SPONDENCE** | **NATURE OF EVIDENCE USED** |
| **Tax Return of an Individual** |  |  |  |
| **Financial Statements of a Corporation** |  |  |  |
| **Efficiency and Effective­ness of a Computer Installation** |  |  |  |

**ECONOMIC DEMAND FOR AUDITING**

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **Factors Deter­mining Interest Rate** |  | **Risk Free Interest Rate** | **+** | **Business Risk** | **+** | **Informa­tion Risk** |

**INFORMATION RISK**

|  |  |
| --- | --- |
| **CAUSES** | **WAYS TO REDUCE** |
| **⚫ Remoteness  of Information**  **⚫ Biases and  Motives of Provider**  **⚫ Voluminous Data**  **⚫ Complex Exchange Transactions** | **⚫ User Verifies Information**  **⚫ User Shares Information Risk  with Management**  **⚫ Information is  Audited** |

**INFORMATION AND SOURCE OF ASSURANCE**

|  |  |
| --- | --- |
| **INFORMATION** | **ASSURER** |
| **Example: Number of radio listeners** | **Arbitron** |