

Felix I. Lessambo

# Auditing, Assurance Services, and Forensics

A Comprehensive Approach

palgrave  
macmillan

## ACKNOWLEDGEMENTS

Writing a book is always a challenge. But writing a book on “Auditing, Assurance Services, and Forensics” a more daring intellectual exercise for twofold reasons: (i) because of the hard choice of topics to cover, and (ii) audit is part science and part art.

I would like to express my gratitude to those who motivated me all along the project, knowing my dedication to the subject, and thought I am more than able to complete this project: Dr. Gordon Marsha, Dr. Linda Sama, and Jerry Izouele.

Several goods friends provided me with needed guidance and materials to complete this book, while others took from their busiest time to review and comb the manuscripts: Reverend Pastor Roland Dalo, Aline Kabongo.

## DISCLAIMER

While the author has made every effort to ensure that the information in this book is correct at the time of publication, he does not assume and hereby disclaims any liability to any Party for any loss, damage, or disruption caused by errors or omissions, whether such errors or omissions result from negligence, accident, or any other cause.

This publication is designed to provide accurate and authoritative information in regards to the subject matter covered. It is sold on the understanding that the publisher is not engaged in rendering professional services. If professional advice or other expert assistance is needed, the services of a competent professional should be sought.

# CONTENTS

## Part I Audit Framework, Profession, and Standards

<b>1</b>	<b>Overview, History, and Overall Objectives of Auditing</b>	<b>3</b>
1.1	<i>General</i>	3
1.2	<i>Attestations and Assurance Services</i>	4
1.3	<i>Audit Objectives</i>	7
1.4	<i>Overall Objectives</i>	7
1.5	<i>Reasonable Assurance</i>	8
1.6	<i>Terms Engagement</i>	10
1.7	<i>Quality Control of Engagement</i>	14
<b>2</b>	<b>The Audit Profession: The US Sarbanes-Oxley Act</b>	<b>17</b>
2.1	<i>General</i>	17
2.2	<i>The Public Company Accounting Oversight Board</i>	18
2.3	<i>The Audit Committee</i>	26
2.4	<i>Use of IT in SOX Compliance (Auditboard)</i>	27
<b>3</b>	<b>The International Auditing and Assurance Standards Board</b>	<b>35</b>
3.1	<i>General</i>	35
3.2	<i>List of the Standards</i>	36
3.3	<i>IAASB Due Process</i>	37

<b>4</b>	<b>Generally Accepted Auditing Standards, Audit Planning and Engagement Quality Review</b>	<b>41</b>
4.1	<i>General</i>	41
4.2	<i>AICPA Auditing Standards</i>	42
4.3	<i>Interpretive Publications</i>	43
4.4	<i>Other Auditing Publications</i>	43
4.5	<i>PCAOB Auditing Standard</i>	44
4.6	<i>Audit Planning</i>	55
4.7	<i>Engagement Quality Review</i>	59
<b>5</b>	<b>Other Engagements, Reports, and Accounting Services</b>	<b>69</b>
5.1	<i>General</i>	69
5.2	<i>Other Attestation Services</i>	69
5.3	<i>Advisory Services</i>	80
5.4	<i>Non-assurance Services</i>	83
<b>6</b>	<b>Agreed-Upon Procedures</b>	<b>91</b>
6.1	<i>General</i>	91
6.2	<i>Conditions for Engagement Performance</i>	92
6.3	<i>Subject-Matter and Related Assertions</i>	93
6.4	<i>Establishing an Understanding with the Client</i>	94
6.5	<i>Reporting</i>	97
6.6	<i>Case Study: James Thomas McCurdy v. SEC</i>	103
<b>7</b>	<b>Professional Standards: Independence, Integrity, and Objectivity</b>	<b>109</b>
7.1	<i>General</i>	109
7.2	<i>Independence Impairment</i>	110
7.3	<i>Integrity and Objectivity</i>	120
<b>Part II Audit Planning</b>		
<b>8</b>	<b>Audit Planning, Testing, and Materiality</b>	<b>127</b>
8.1	<i>General</i>	127
8.2	<i>Preliminary Engagement Activities</i>	128
8.3	<i>Involvement of Professionals Possessing Specialized Skills</i>	131

8.4	<i>Documentation</i>	131
8.5	<i>Planning Activities</i>	132
8.6	<i>The Role and Timing of Planning</i>	132
8.7	<i>Changes During the Course of the Audit</i>	133
8.8	<i>Supervision of Engagement Team Members</i>	134
8.9	<i>Consideration of Materiality in Planning and Performing an Audit</i>	135
8.10	<i>The Auditor's Responses to the Risks of Material Misstatement</i>	139

### **Part III Audit Evidence Processing**

<b>9</b>	<b>Audit Evidence and Documentation</b>	155
9.1	<i>General</i>	155
9.2	<i>Sources of Audit Evidence</i>	156
9.3	<i>Relevance and Reliability</i>	156
9.4	<i>Management Assertions Over Financial Statement</i>	158
9.5	<i>Audit Procedures for Obtaining Audit Evidence</i>	159
9.6	<i>Reliability of Information Produced by a Management's Specialist</i>	163
9.7	<i>Audit Documentation</i>	164
9.8	<i>Evaluating the Audit Result</i>	171
9.9	<i>The Use of Blockchain Technology in Auditing</i>	178
<b>10</b>	<b>Audit Risks: Identification and Procedures</b>	183
10.1	<i>General</i>	183
10.2	<i>Characteristics of Fraud</i>	183
10.3	<i>Risk of Material Misstatement</i>	184
10.4	<i>Detection Risk</i>	185
10.5	<i>Performing Risk Assessment Procedures</i>	185
10.6	<i>Identifying and Assessing the Risks of Material Misstatement</i>	198
<b>11</b>	<b>Audit Sampling</b>	203
11.1	<i>General</i>	203
11.2	<i>Sampling and Non-sampling Risks</i>	204

11.3	<i>Sampling in Substantive Tests of Details</i>	205
11.4	<i>Sampling in Tests of Controls</i>	208
11.5	<i>Dual-Purpose Samples</i>	211
11.6	<i>Use of IT in Sampling</i>	212
<b>12</b>	<b>Auditing Accounting Estimates, Including Fair Value Accounting Estimates</b>	215
12.1	<i>General</i>	215
12.2	<i>Auditing Accounting Estimates</i>	215
12.3	<i>Auditing Fair Value Estimates</i>	219
12.4	<i>Assessment of Fair Value Levels</i>	223
<b>13</b>	<b>Related Party Transactions</b>	229
13.1	<i>General</i>	229
13.2	<i>Examples of Transactions with Related Parties Include, Among Others</i>	230
13.3	<i>Audit Procedures</i>	231
13.4	<i>Evaluating Whether the Company Has Properly Identified Its Related Parties and Relationships and Transactions with Related Parties</i>	235
13.5	<i>Communications with the Audit Committee</i>	237
<b>14</b>	<b>Significant Unusual Transactions</b>	239
14.1	<i>General</i>	239
14.2	<i>Auditor Requirements</i>	240
14.3	<i>Identifying Significant Unusual Transactions</i>	242
14.4	<i>Audit Risk Procedures</i>	242
14.5	<i>Management and Audit Committee Responsibilities</i>	243
<b>15</b>	<b>Subsequent Events; and Going Concern</b>	247
15.1	<i>General</i>	247
15.2	<i>Types of Subsequent Events</i>	248
15.3	<i>Re-issuance of Financial Statements</i>	249
15.4	<i>Audit Procedures for Subsequent Events</i>	250
15.5	<i>Going Concern</i>	252

<b>16</b>	<b>Reporting on Condensed Financial Statements, Selected Financial Data, and Supplemental Information</b>	<b>261</b>
16.1	<i>General</i>	261
16.2	<i>Condensed Financial Statements</i>	262
16.3	<i>Selected Financial Data</i>	264
<b>17</b>	<b>Consideration of Fraud and of Internal Control Over Financial Reporting Audit</b>	<b>273</b>
17.1	<i>General</i>	273
17.2	<i>Types of Misstatements</i>	273
17.3	<i>Exercising Professional Skepticism</i>	274
17.4	<i>Identifying the Risks of Material Misstatement Due to Fraud</i>	275
17.5	<i>Evaluating Audit Evidence</i>	276
17.6	<i>Communicating to Management, Those Charged with Governance, and Others</i>	277
17.7	<i>Audits of Internal Control Over Financial Reporting</i>	279
<b>18</b>	<b>Financial Statements' Audit</b>	<b>289</b>
18.1	<i>General</i>	289
18.2	<i>Financial Statement Assertions</i>	289
18.3	<i>Cash and Cash Equivalent</i>	290
18.4	<i>Receivables or Revenue Cycle</i>	292
18.5	<i>Inventories</i>	294
18.6	<i>Plant, Property, and Equipment</i>	299
18.7	<i>Account and Notes Payables</i>	301
18.8	<i>Equity Capital</i>	303
18.9	<i>Long-Term Debt</i>	304
<b>19</b>	<b>The Integrated Audit Process</b>	<b>309</b>
19.1	<i>General</i>	309
19.2	<i>Audit of Internal Control Over Financial Reporting (ICFR)</i>	309
19.3	<i>Audit of Financial Statements</i>	327
19.4	<i>The Ongoing Concern Report</i>	336



<b>20</b>	<b>Audits of Group Financial Statements</b>	<b>343</b>
20.1	<i>General</i>	343
20.2	<i>Audit Strategy and Audit Plan</i>	344
20.3	<i>Independence and Competence of the Component Auditor</i>	347
20.4	<i>Assessment of Materiality in Group Audit</i>	349
20.5	<i>Audit Test Related to Group Audit</i>	351
20.6	<i>The Evaluation of the Sufficiency and Appropriateness of Audit Evidence</i>	353
20.7	<i>Communication Between the Lead Auditor and the Group</i>	353
20.8	<i>Documenting a Group Audit</i>	355
20.9	<i>The Consolidation Process</i>	355
20.10	<i>Conclusion</i>	356
<b>21</b>	<b>Communications with Audit Committees</b>	<b>359</b>
21.1	<i>General</i>	359
21.2	<i>Objectives</i>	359
21.3	<i>The Scope of the Communication</i>	360
21.4	<i>Form and Documentation of Communications</i>	367
21.5	<i>Timing</i>	367
<b>22</b>	<b>Audit Tools: Financial Ratios Analysis</b>	<b>371</b>
22.1	<i>General</i>	371
22.2	<i>Liquidity Measurement Ratios</i>	371
22.3	<i>Solvency Ratios</i>	375
22.4	<i>Profitability Indicator Ratios</i>	377
22.5	<i>Efficiency Ratios</i>	380
22.6	<i>Debt Ratios</i>	383
22.7	<i>Operating Performance Ratios</i>	385
22.8	<i>Cash Flow Indicator Ratios</i>	388
22.9	<i>Investment Valuation Ratios</i>	389
22.10	<i>Limitations</i>	392
<b>23</b>	<b>Corporate Governance, Accounting, and Auditing Scandals</b>	<b>395</b>
23.1	<i>General</i>	395
23.2	<i>The Triangle of Fraud</i>	395

23.3	<i>Scandals in the United States</i>	397
23.4	<i>Diagnosis of the Scandals</i>	407
<b>24</b>	<b>Auditor Legal Liability</b>	<b>411</b>
24.1	<i>General</i>	411
24.2	<i>Auditor Contractual Liability: The Engagement Letter</i>	411
24.3	<i>Auditor Common Law Tort Liability</i>	413
24.4	<i>Auditor Liabilities Vis-à-Vis Third-Party Claimants</i>	417
24.5	<i>The Auditor Defenses</i>	424
24.6	<i>Auditor Federal Statutory Liability</i>	432
24.7	<i>Auditor State Liability</i>	438
24.8	<i>Auditor Criminal Liability</i>	439
24.9	<i>Conclusion</i>	443
<b>25</b>	<b>Forensic Auditing</b>	<b>447</b>
25.1	<i>Introduction</i>	447
25.2	<i>The PCAOB Objectives of Forensic Audit</i>	448
25.3	<i>The International Auditing and Assurance Standards Board (ISA 240)</i>	449
25.4	<i>Forensic Auditing Services</i>	450
25.5	<i>Forensic Audit and Fraud Detection</i>	450
25.6	<i>Forensic Audit Procedures</i>	455
25.7	<i>Investigation Techniques and Digital Evidence</i>	456
25.8	<i>Case Study</i>	462
	<b>Glossary of the Terms</b>	<b>469</b>
	<b>Bibliography</b>	<b>481</b>
	<b>Answers to Chapter Questions</b>	<b>485</b>
	<b>Index</b>	<b>491</b>

# ABBREVIATIONS

AICPA	American Institute of Certified Public Accountants
CAG	Consultative Advisory Group
CAQ	Center for Audit Quality
CISA	Certified Information Systems Auditor
CMA	Certifies Management Accounting
CPA	Certified Public Accountant
FASAB	Federal Accounting Standards Advisory Board
FASB	Financial Accounting Standards Board
FIFO	First In First Out
FINRA	Financial Industry Regulatory
GAAP	Generally Accepted Accounting Principles
GAAS	Generally Accepted Auditing Standards
IAASB	International Auditing and Assurance Standards Board
IAG	International Auditing Guidelines
IAPC	International Auditing Practices Committee
ISA	International Standards on Auditing
ISB	Independence Standards Board
LIFO	Last In First Out
PCAB	Public Company Accounting Oversight Board
PIOB	Public Interest Oversight Board
QC	Quality Control
SEC	Securities and Exchange Commission
SOX Act	Sarbanes-Oxley Act
SQCS	Statement on Quality Control Standards
SRTPs	Statements on Responsibilities in Tax Practice
SSARS	Statements on Standards for Accounting and Review Services

SSTS	Statements on Standards for Tax Services
SSVS	Statements on Standards for Valuation Services