

**I - MULTIPLE CHOICE QUESTIONS (50%)**

1. Which of the following substantive procedures provides evidence over the COMPLETENESS of non-current assets?
  - A. Select a sample of assets included in the non-current asset register and physically verify them at the client premises
  - B. Review the repairs and maintenance expense account to identify any items of a capital expenditure nature
  - C. For assets disposed of, agree the sale proceeds to supporting documentation and cash book
2. The audit report date on a standard unqualified report indicates:
  - A. the last day of the fiscal period.
  - B. the date on which the financial statements were filed with the Ministry of Finance.
  - C. the last date on which users may institute a lawsuit against either the client or the auditor.
  - D. the last day of the auditor's responsibility for the review of significant events that occurred after the date of the financial statements.
3. Recklessness in the case of an audit is present if the auditor knew an adequate audit was not done but still issued an opinion, even though there was no intent to deceive financial statement users. This description is the legal term for:
  - A. ordinary negligence.
  - B. gross negligence.
  - C. constructive fraud.
  - D. fraud.
4. The members of a client's "audit committee" should be:
  - A. members of management.
  - B. directors who are not a part of company management.
  - C. non-directors and non-managers.
  - D. directors and managers.
5. The accounting firm of Bayer & Peng, CPAs, is negotiating a fee with a new audit client. They agree the client will pay \$50,000 if Bayer & Peng issues a clean, unqualified opinion, \$40,000 if a qualified opinion is issued, and only \$20,000 if an adverse opinion is issued. Does this agreement constitute a Violation?
  - A. Yes
  - B. No
6. \_\_\_\_\_ is (are) the detailed instruction (s) that explain(s) the audit evidence to be obtained during the audit.
  - A. audit objectives
  - B. audit procedures
  - C. audit assertion
  - D. audit program

7. Evidence is usually more persuasive for balance sheet accounts when it is obtained:
- A. as close to the balance sheet date as possible.
  - B. only from transactions occurring on the balance sheet date.
  - C. from various times throughout the client's year.
  - D. from the time period when transactions in that account were most numerous during the fiscal period.
8. Which of the following is **not** a correct combination of terms and related type of audit evidence?
- A. Inquire — inquiries of client
  - B. Count — physical examination
  - C. Recompute — documentation
  - D. Read — documentation
9. Initial audit planning involves four matters. Which of the following is **not** one of these?
- A. Develop an overall audit strategy.
  - B. Request that bank balances be confirmed.
  - C. Schedule engagement staff and audit specialists.
  - D. Identify the client's reason for the audit.
10. An auditor should examine minutes of the board of directors' meetings:
- A. through the date of the financial statements.
  - B. through the date of the audit report.
  - C. only at the beginning of the audit.
  - D. on a test basis.
11. Business risk:
- A. is the risk after considering the effectiveness of top management controls.
  - B. is the risk that the client's internal controls will fail.
  - C. can include a new technology which threatens to erode a company's competitive advantage.
  - D. cannot be mitigated by management.
12. Auditors are responsible for determining whether financial statements are materially misstated, so upon discovering a material misstatement they must bring it to the attention of:
- A. regulators.
  - B. the audit firm's managing partner.
  - C. the client shareholders.
  - D. the client.
13. As the risk of material misstatement increases, detection risk should:
- A. moderately increase.
  - B. decrease.
  - C. stay the same.
  - D. Is indeterminate.

14. Internal controls:
- A. are implemented by and are the responsibility of the auditors.
  - B. consist of policies and procedures designed to provide reasonable assurance that the company achieves its objectives and goals.
  - C. guarantee that the company complies with all laws and regulations.
  - D. only apply to SEC companies.
15. Which of the below control activities should be in place when auditing small scale companies:
- A. a wider segregation of duties.
  - B. a voucher system.
  - C. fewer transactions to process.
  - D. the owner-manager's direct involvement in the control process.
16. Who is most likely to perpetrate fraudulent financial reporting?
- A. Members of the board of directors
  - B. Production employees
  - C. Management of the company
  - D. The internal auditors
17. Which audit tests involve physical examination and confirmation?
- A. Tests of controls
  - B. Tests of transactions
  - C. Tests of balances
  - D. Analytical procedures
18. The auditors principal objective when using a sample of tests of details of balances is whether the:
- A. account balance being audited is fairly stated.
  - B. transactions being audited are free of misstatements.
  - C. controls being tested are operating effectively.
  - D. transactions and account balances being audited are fairly stated.
19. You are auditing Raji and Company. You discover an item of inventory with an audited value of \$5,000 with a recorded amount of \$3,000. If this is the only error you discover the projected misstatement for the sample would be:
- A. \$5,000.
  - B. \$2,000.
  - C. \$3,000.
  - D. \$4,000.
20. In monetary unit sampling, a sampling interval of 900 means that:
- A. every 900th item will be selected.
  - B. every 900th dollar in the account will be sampled.
  - C. expected misstatement is 900.
  - D. tolerable misstatement is 900.
21. An accounts receivable population contains a total of four customers. The accounts, the amounts, and the cumulative total are shown below. Monetary unit sampling is to be used.

Account Name	Recorded Amount	Cumulative Total
Blue	\$ 357	\$ 357
Brown	281	638
Gray	60	698
Green	574	1,272

Based on the information above, the population size is:

- A. 4.
  - B. 574.
  - C. 1,272.
  - D. \$2,684.
22. \_\_\_\_\_ is a balance-related audit objective that is not applicable to liabilities.
- A. Existence
  - B. Accuracy
  - C. Completeness
  - D. Realizable value
23. Cutoff procedures for inventory purchased should be designed by companies to assure that the company's:
- A. inventory owned has been received.
  - B. inventory included in the year end inventory count has been paid.
  - C. inventory received before year end was recorded before year end.
  - D. inventory was correctly valued at year end.
24. The auditor has decided to use accounts payables confirmations when testing substantive testing for balances. Which two management assertions is she testing?
- A. Existence and completeness
  - B. Existence and occurrence
  - C. Existence and accuracy
  - D. Completeness and obligations
25. The two most important balance related objectives in notes payable are:
- A. completeness and accuracy.
  - B. existence and completeness.
  - C. accuracy and classification.
  - D. existence and occurrence.
26. All of the following would not be uncovered by a bank reconciliation except for:
- A. duplicate payment of a vendor's invoice.
  - B. improper payments of officers' personal expenditures.
  - C. payments on notes payable debited directly to the bank account by the bank but not recorded on the books.
  - D. payment to an employee for more hours than he worked.

27. Because cash is the most desirable asset for people to steal, it has a higher:
- A. control risk.
  - B. inherent risk.
  - C. detection risk.
  - D. liquidity risk.
28. The auditor's primary concern relative to presentation and disclosure-related objectives is:
- A. accuracy.
  - B. existence.
  - C. completeness.
  - D. occurrence.
29. One of the primary approaches in dealing with uncertainties in loss contingencies uses a \_\_\_\_\_ threshold.
- A. monetary
  - B. materiality
  - C. probability
  - D. analytical
30. Auditors will generally send a standard inquiry letter to:
- A. only those attorneys who have devoted substantial time to client matters during the year.
  - B. every attorney that the client has been involved with in the current or preceding year, plus any attorney the client engages on occasion.
  - C. those attorneys whom the client relies on for advice related to substantial legal matters.
  - D. only the attorney who represents the client in proceeding where the client is defendant.
31. An auditor has the responsibility to actively search for subsequent events that occur subsequent to the:
- A. balance sheet date.
  - B. date of the auditor's report.
  - C. balance sheet date, but prior to the audit report.
  - D. date of the management representation letter.
32. When should auditors generally assess a client's ability to continue as a going concern?
- A. Upon completion of the audit
  - B. During the planning stages of the audit
  - C. Throughout the entire audit process
  - D. During testing and completion phases of the audit
33. Which of the following audit procedures would most likely assist an auditor in identifying conditions and events that may indicate there could be substantial doubt about an entity's ability to continue as a going concern?
- A. Review compliance with the terms of debt agreements
  - B. Confirmation of accounts receivable from principal customers

- C. Reconciliation of interest expense with debt outstanding  
D. Confirmation of bank balances
34. The statement that "We are not aware of any material modifications that should be made to the accompanying financial statements" expresses which of the following?  
A. Disclaimer of an opinion  
B. Negative assurance  
C. Negative confirmation  
D. Shared opinion
35. Which of the following types of engagement reports would provide positive assurance?  
A. An attestation  
B. A review  
C. An agreed-upon procedures engagement  
D. A compilation
36. Which TWO of the following should be included in an audit engagement letter?  
(1) Objective and scope of the audit  
(2) Results of previous audits  
(3) Management's responsibilities  
(4) Need to maintain professional scepticism  
A. 1 and 2  
B. 1 and 3  
C. 2 and 4  
D. 3 and 4
37. ISA 580 Written Representations require auditors to obtain written representations to support other evidence.  
For which of the following matters would a written representation NOT be suitable as audit evidence?  
A. That all deficiencies in internal control known to management have been communicated to the auditor  
B. That subsequent events requiring adjustment or disclosure in the financial statements have been dealt with appropriately  
C. That the payroll charge for three months of the year when the accounting records were unavailable is correctly stated  
D. That management has fulfilled their responsibility for the preparation and presentation of the financial statements
38. Which TWO of the following substantive procedures provide evidence over the EXISTENCE of trade receivables?  
(1) Agreeing a sample of goods despatched notes to sales invoices and to the sales ledger  
(2) Undertaking a receivables circularisation  
(3) Review of post year-end cash receipts, if these relate to year-end receivables follow through to the sales ledger  
(4) Recalculating the allowance for uncollectible accounts  
A. 1 and 3

- B. 2 and 4
  - C. 2 and 3
  - D. 1 and 4
39. Which of the following procedures are TESTS OF CONTROL an auditor should perform in testing the inventory cycle of their client whilst attending the inventory count?
- (1) Observe whether the client's staff are following the inventory count instructions
  - (2) Review inventory present in the warehouse for evidence of damage or obsolescence
  - (3) Obtain a sample of the last goods received notes and goods dispatched notes and follow through to ensure inclusion in the correct accounting period
  - (4) Inspect and review management's inventory count instructions
- A. 2 and 3
  - B. 1 and 4
  - C. 1 and 2
  - D. 3 and 4
40. Which of the following statements, if any, is/are correct?
- (1) Internal auditors should report to the finance director as they understand internal controls and are best placed to implement any recommendations in a timely manner
  - (2) Companies are not required to establish and maintain an internal audit function
- A. 1 only
  - B. 2 only
  - C. Both 1 and 2
  - D. Neither 1 nor 2
41. In testing plant and equipment balances, an auditor examines new additions listed on an analysis of plant and equipment. This procedure most likely obtains evidence concerning management's assertion of
- A. Completeness
  - B. Existence or occurrence
  - C. Presentation and disclosure
  - D. Valuation or allocation
42. Which of the following is NOT an inherent limitation of internal control systems?
- A. Insufficient segregation of duties
  - B. Possibility that employees may collude together fraudulently
  - C. Possibility of human error in undertaking tasks
43. Which of the following statements, relating to International Standards on Auditing (ISAs), if any, is/are correct?
- (1) International Standards on Auditing (ISAs) are issued by the International Accounting Standards Board (IASB) and provide guidance on the performance and conduct of an audit
  - (2) In the event that ISAs differ from local legislation in a specific country, auditors must comply with the requirements of the ISAs
- A. 1 only
  - B. 2 only
  - C. Both 1 and 2

- D.** Neither 1 nor 2
44. An auditor establishes quality control policies and procedures for deciding whether to accept a new client or continue to perform services for a current client. The primary purpose for establishing such policies and procedures is
- A.** To enable the auditor to attest to the integrity or reliability of a client.
  - B.** To comply with the quality control standards established by regulatory bodies.
  - C.** To minimize the likelihood of association with clients whose management lacks integrity.
  - D.** To lessen the exposure to litigation resulting from failure to detect irregularities in client financial statements.
45. Auditing standards require that the examination of financial statements is to be performed by a person or persons having adequate technical training and
- A.** Independence with respect to the financial statements and supplementary disclosures.
  - B.** Exercising professional care as judged by peer reviewers.
  - C.** Proficiency as an auditor which likely has been acquired from previous experience.
  - D.** Objectivity as an auditor as verified by proper supervision
46. The most important general ledger account included in and affecting several cycles is the:
- A.** cash account.
  - B.** inventory account.
  - C.** income tax expense and liability accounts.
  - D.** retained earnings account.
47. Which of the following accounts is not part of the acquisition and payment cycle?
- A.** Prepaid expenses
  - B.** Accounts payable
  - C.** Sales returns and allowances
  - D.** Property, plant, and equipment
48. Which of the following material events occurring subsequent to the balance sheet date would require an adjustment to the financial statements before they could be issued?
- A.** Loss of a plant as a result of a flood
  - B.** Sale of long-term debt or capital stock
  - C.** Settlement of litigation in excess of the recorded liability
  - D.** Major purchase of a business that is expected to double the sales volume
49. The process by which LACPA members assigned by a special committee reviews the operational procedures of another LACPA firm or member to ensure that those procedures meet certain standards is called
- A.** Operational Audit
  - B.** Audit on Special procedure
  - C.** Peer review
  - D.** Compilation

50. Which of the following factors most likely would influence an auditor's determination of the auditability of an entity's financial statements
- A. The complexity of the accounting system
  - B. The existence of related party transactions
  - C. The adequacy of the accounting records
  - D. The operating effectiveness of control procedures

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**TRUE & FALSE (14%)**

1. If an auditor assigns a tolerable misstatement of \$1,000 to accounts payable, he or she would need to obtain more audit evidence for that account than if \$100,000 had been assigned.
2. The cash account is not part of the acquisitions and payment cycle.
3. When a successor auditor contacts a company's previous auditor, the predecessor auditor is required to respond fully and without limit to the request for information.
4. All known related parties must be identified and included in the auditor's permanent files related to the client.
5. Walkthroughs combine observation, inspection, and inquiry to assure that the controls designed by management have been implemented.
6. Current professional auditing standards mandate the use of analytical procedures during the testing phase of the audit.
7. Review reports are normally dated as of the client's balance sheet date.
8. A modified unqualified audit report arises when the auditor believes the financials are fairly stated but also believes additional information should be provided.
9. When an auditor believes that an illegal act may have occurred, the first step he or she should take is to gather additional evidence to determine the extent of the illegality and if there is a direct impact on the financial statements.
10. Audits are expected to provide a higher degree of assurance for the detection of material frauds than is provided for an equally material error.
11. Audit documentation is the joint property of the auditor and the audit client.
12. For prospective clients that have previously been audited by another CPA firm, the predecessor auditor is required to communicate with the successor auditor.
13. An engagement letter can affect the CPA firm's legal responsibilities to the client, but does not affect responsibility to external users of audited financial statements.

14. Tests of controls should be performed after substantive tests of transactions.

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**MATCHING (6%)**

Match three of the terms (a-f) with the definitions provided below (1-3):

- a. Control environment
- b. Internal control
- c. Monitoring
- d. Separation of duties
- e. General authorization
- f. Risk assessment

- \_\_\_\_\_ 1. Segregation of the following activities in an organization: custody of assets, accounting, authorization, and operational responsibility.
- \_\_\_\_\_ 2. Management's identification and analysis of risks relevant to the preparation of financial statements in accordance with an applicable accounting framework.
- \_\_\_\_\_ 3. A process designed to provide reasonable assurance regarding the achievement of management's objectives in the following categories:  
(1) reliability of financial reporting,  
(2) effectiveness and efficiency of operations, and  
(3) compliance with applicable laws and regulations.

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**III) SHORT QUESTIONS (Please answer in bullet points) (30%)**

**Question I ( 10 % )**

ISA 700 Forming an Opinion and Reporting on Financial Statements requires auditors to produce an audit report. This report should contain a number of consistent elements so that users are able to understand what the audit report means.

**Required:**

**Describe FIVE elements of an unmodified (new) auditor's report.**

**QUESTION II ( 10 % )**

You are the audit supervisor of Seagull & Co and are currently planning the audit of your existing client, Eagle Heating Co (Eagle), for the year ending 31 December 2014. Eagle manufactures and sells heating and plumbing equipment to a number of home improvement stores across the country.

- A-** Eagle has experienced increased competition and as a result, in order to maintain its current levels of sales, it has decreased the selling price of its products significantly since September 2014. The finance director has informed your audit manager that he expects increased inventory levels at the year end.
- B-** He also notified your manager that one of Eagle's key customers has been experiencing financial difficulties. Therefore, Eagle has agreed that the customer can take a six-month

payment break, after which payments will continue as normal. The finance director does not believe that any allowance is required against this receivable.

- C- In October 2014 the financial controller of Eagle was dismissed. He had been employed by the company for over 20 years, and he has threatened to sue the company for unfair dismissal. The role of financial controller has not yet been filled and so his tasks have been shared between the existing finance department team.
- D- In addition, the purchase ledger supervisor left in August and a replacement has been appointed in the last week. However, for this period no supplier statement reconciliations or purchase ledger control account reconciliations were performed.
- E- You have undertaken a preliminary analytical review of the draft year to date statement of profit or loss, and you are surprised to see a significant fall in administration expenses.

**Required:**

**List (with brief explanation) FIVE audit risks that the auditor must identify, and address the audit procedure to perform in order to mitigate those risks.**

**QUESTION III ( 10 %)**

Bullfinch.com is a website design company whose year-end was 31 October 2014. The audit is almost complete and the financial statements are due to be signed shortly. Revenue for the year is \$11.2 million and profit before tax is \$3.8 million. A key customer, with a receivables balance at the year-end of \$283,000, has just notified Bullfinch.com that they are experiencing cash flow difficulties and so are unable to make any payments for the foreseeable future (information was received after year end). The finance director has notified the auditor that he will write this balance off as an irrecoverable debt in the 2015 financial statements.

**Required:**

- (i) **Explain whether or not the 2014 financial statements require amendment; (4 %)** and
- (ii) **Describe audit procedures which should be performed in order to form a conclusion on any required amendment. (6 %).**