

MULTIPLE CHOICE QUESTIONS (53%)

- 1 The following statements relate to International Standards on Auditing (ISAs) and professional auditors:
- (1) All ISAs must be applied during the course of an audit.
 - (2) ISAs override local regulations.
 - (3) The entire text of a standard must be understood in order to apply its requirements.
 - (4) ISAs are rules-based and all rules must be applied.
 - (5) An individual is appropriately qualified as an auditor on passing professional examinations.
 - (6) In most jurisdictions only a statutory auditor is allowed to carry out audits of companies.

Which of the above statements are true?

- A** All of them
B 3 and 6 only
C 1, 3 and 6 only
D 1, 2, 5 and 6 only

- 2 The following are statements that could be made about corporate governance:

- (1) The system by which business corporations are directed and controlled.
- (2) It involves entrepreneurship, innovation, development and exploration.
- (3) It aims to achieve a long-term increase in shareholder value.
- (4) It narrows the expectation gap.
- (5) It only applies to entities that are listed on a stock exchange.

What combination of these statements best describes the meaning of corporate governance?

- A** 1, 4 and 5
B 1, 2 and 5
C 1, 2 and 3
D 2, 3 and 5

- 3 **Which of the following statements *best* expresses the auditor's duty of confidentiality to his client in respect of information acquired in the course of professional work?**

- A** The auditor should only reveal confidential client data after having received consent from the board of directors to do so
- B** The auditor must supply any client data requested of him by a shareholder at the annual general meeting
- C** The auditor should never reveal client confidential data unless it is essential to the understanding of a modified audit report
- D** The auditor should reveal certain client confidential data if he believes that he has a legal right or duty to do so

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- 4 A potential client has asked a firm to act as auditor to his company and wants the audit to commence immediately as the financial statements are required by the bank.
- What should the auditor's response be?**
- A Start work on the audit right away
 - B Inform the previous auditors that they intend to commence work
 - C Contact the previous auditors for professional clearance before they start work
 - D Accept the assignment subject to written confirmation of appointment by the Board
- 5 **Which of the following is an advantage of using standardised working papers?**
- A Ensures the completeness of the audit working papers by the placing of a standard programme on each section of the audit file
 - B Introduces a standard approach to the conduct and documentation of the audit
 - C Enables junior staff to follow properly documented and designed procedures thereby reducing the need for excessive supervision
 - D Facilitates briefing, delegation, supervision, review and quality control of the audit work
- 6 Which of the following statements is FALSE with regard to audit planning?
- A It helps the auditors to devote appropriate attention to important areas of the financial statements
 - B It helps the auditor to properly organise and manage the audit engagement, so that it is performed in an effective manner
 - C It provides assurance to the auditor that the risk of a material misstatement in the financial statements will be reduced
 - D It facilitates the direction and supervision of audit team members and the review of their work
- 7 An audit client sells around 30 units of product each year. The majority of sales are made in the first nine months of the year. Annual sales have not changed significantly in the past five years.
- Which of the following approaches to the audit of revenue would be most effective?**
- A Perform all audit procedures after the year end because the volume of transactions is low
 - B Perform tests of details at the end of nine months followed by analytical procedures from that interim date to the year end
 - C Perform analytical procedures at the end of nine months and additional analytical procedures after the year end
 - D Perform tests of controls at the end of nine months and tests of details at the year end

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8	<p>Which component of audit risk should be considered if an entity has few employees in its accounting department?</p>
	<p>A Inherent B Control C Detection</p>
9	<p>Which of the following is THE LEAST benefit of an effective system of internal control?</p>
	<p>A Enhanced profitability B Better management of assets and liabilities C Cutting down the time needed for the audit D Compliance with laws and regulations</p>
10	<p>An effective system of internal control requires segregation of basic functions (segregation of duties).</p>
	<p>Which THREE of the following functions should ideally be segregated?</p>
	<p>(1) Authorisation of transactions (2) Preparation of financial statements (3) Custody or handling of assets (4) Budgetary control (5) Recording of transactions</p>
	<p>A 1, 3 and 5 B 1, 2 and 3 C 1, 2 and 5 D 3, 4 and 5</p>
11	<p>The external auditor of Aaron Co has set a planning materiality threshold of \$40,000 and a performance materiality of \$30,000. The audit testing approach to the following financial statement items is being considered:</p>
	<p>(1) Harry, a director of Aaron Co, owes \$1,000 to the company (borrowed during the year). (2) Sundry income of \$35,000</p>
	<p>Which of the two items should be tested?</p>
	<p>A Neither 1 nor 2 B Both 1 and 2 C 1 only D 2 only</p>
12	<p>A client high-tec company has financial problems, a dominant chief executive, poor internal control and unusual transactions.</p>
	<p>What are all of these factors indicative of?</p>
	<p>A Inadequacies in the systems of reporting B The presence of going concern problems C Increased scope for potential fraud D Increased audit risk</p>

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13	<p>An auditor has discovered a \$10,000 wages fraud by a director of a listed company. The amount is not material in relation to the financial statements of the company and the auditor has determined that the fraud does not constitute money laundering.</p> <p>To whom does the auditor have a primary duty to report this matter to?</p>
	<p>A Those charged with governance B The company's shareholders C The tax authorities</p>
14	<p>An auditor has identified the financial controller's review of the bank reconciliation as a control to test. In connection with this test, the auditor interviews the financial controller to understand the specific data reviewed on the reconciliation. In addition, the auditor verifies that the bank reconciliation is properly prepared by the accountant and reviewed by the financial controller as evidenced by their respective sign-offs.</p> <p>Which of the following types of audit procedures do these actions illustrate?</p>
	<p>A Inquiry and inspection of records B Confirmation and reperformance C Analytical procedures and reperformance D Observation and inspection of records</p>
15	<p>Which of the following would cause an auditor to perform tests of controls after obtaining an understanding of the entity and its environment?</p>
	<p>A There were many internal control weaknesses that could result in misstatements B The auditor's risk assessment is based on controls operating effectiveness C An increased level of control risk has been assessed</p>
16	<p>Which of the following techniques provides the <i>least</i> assurance about the operating effectiveness of an internal control?</p>
	<p>A Inquiry of client personnel B Inspection of documents and reports C Observation of client personnel D Preparation of system flowcharts</p>
17	<p>During the audit of a new client numerous weaknesses have been identified. The auditor is considering the content and format of his report to management (letter of weakness).</p> <p>Which of the following best summarises the auditor's approach to the report?</p>
	<p>A Include all matters of sufficient importance identified, but structure the letter to take account of the varying levels of significance of matters included B Report only major points to be dealt with by directors, leaving less important items to be discussed informally with members of the client's staff C Report only those matters which potentially have a material effect on the true and fair view shown by the financial statements, indicating that this should not be regarded as a comprehensive statement of all weaknesses that exist D Issue separate reports for each area to the executive directors with specific responsibility in those areas</p>

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18 An auditor recalculates the amortisation of intangible assets to determine whether the amortisation period is reasonable.

Which financial statement assertion is being tested?

- A Valuation and allocation
- B Existence
- C Completeness

19 **In order to detect an understatement of sales, which of the following procedures would be most effective?**

- A Select sales delivery notes and check the details with the related sales invoices
- B Select sales invoices and check the details with the related sales orders
- C Select sales invoices and check the details with the related sales delivery notes
- D Select sales orders and check the details with the related sales invoices

20 Growers Co is a garden centre with 20 locations employing over two hundred people. To cope with the current and expected future annual increase in transactions, Growers has implemented a centralised computer system linked to processing and checkout terminals at each centre. The new system will significantly improve the timing and quality of the management control information. A well-qualified and experienced internal audit team was also recently appointed.

What area of the external audit will see an increased emphasis on obtaining audit assurance?

- A Walk-through testing
- B Controls testing
- C Substantive testing of transactions
- D Substantive testing of balances

21 **What assertion is an auditor testing when the auditor gathers evidence to detect sales made after the end of the year that have been recorded before year end?**

- A Cut-off
- B Accuracy
- C Completeness

22 **Which of the following is a substantive procedure?**

- A Verifying that invoices payable are appropriately approved
- B Observing the distribution of a payroll on an unannounced basis
- C Performing suppliers' statement reconciliations

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- 23 **A review of the revenues and expenses in the detailed profit and loss account of a company, involving investigation of significant variations in comparison with the equivalent figures for the previous year, is most likely to detect which of the following significant problems?**
- A The fact that a line of inventory has become obsolete during the year and should be written off
 - B A misallocation of distribution costs as advertising expenses
 - C The fact that the costs of some exceptional repairs to the company's premises have not been included in the profit and loss account
 - D Failure to make a provision for volume discounts which have been introduced this year for certain customers
- 24 Hardware Co has a fixed mark-up of 50% on cost. The external auditor's analytical review of the current financial statements has revealed a gross profit margin of 40% of sales.
- What could this indicate?**
- A Some sales have not been invoiced
 - B Some purchases have not been recorded
 - C Closing inventory has been undervalued
 - D Goods used for personal consumption have been included in purchases
- 25 **Which of the following approaches to evaluating the reasonableness of an accounting estimate would provide insufficient audit evidence?**
- A Review subsequent events or transactions occurring prior to audit completion
 - B Develop an independent expectation of the estimate
 - C Review and test the process used to develop the estimate
 - D Review the minutes of board of directors and shareholder meetings for discussion of the estimate
- 26 **Which of the following is NOT a factor that may influence the estimation of uncertainty?**
- A Management judgement
 - B Observable or unobservable inputs
 - C The length of any forecast period
 - D The auditor's professional judgement

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27 In using the work of an audit expert, an auditor referred to the expert's findings in the auditor's report.

Under what circumstances would this be appropriate?

- A The client is not familiar with the professional certification, personal reputation, or particular competence of the auditor's expert
- B The auditor, as a result of the expert's findings, adds explanatory detail to a modified opinion regarding the reasons for the opinion
- C The auditor understands the form and content of the expert's findings in relation to the representations in the financial statements
- D The auditor, as a result of the expert's findings, decides to indicate a division of responsibility with the expert

28 As part of the audit testing to satisfy the audit objective "Receivables are not overstated", the audit senior of a manufacturing company plans a receivables confirmation.

Which of the following approaches would be the most appropriate in these circumstances?

- A A random sample selected from the population of individual customers used during the year
- B A sample selected from the population of individual customers used during the year, with a bias towards those having the highest value of transactions in the year
- C A random sample selected from the population of customers' year end balances
- D A sample selected from the population of customers' year end balances, with a bias towards large balances

29 **Which of the following statements are NOT true?**

- (1) The higher the entity risk the greater the sample size
 - (2) The bigger the population the bigger the sample size
 - (3) The lower the acceptable detection risk the lower the sample
 - (4) The higher the tolerable error the lower the sample size
 - (5) The higher the expected error the lower the sample size
 - (6) The more effective the stratification the lower the sample size
- A 2, 3, 5 and 6 only
 - B 2 and 5 only
 - C 1, 4 and 6 only
 - D 2, 3 and 5 only

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30 In the course of auditing a company an auditor will receive verbal representations from management for which independent evidence is not available.

On what basis should the auditor seek written confirmation of these representations from the directors?

- A To ensure that the directors formally accept their responsibility for providing such information to the auditor
- B To enable the auditor to escape legal liability for any misstatement in the accounts
- C To prove that the directors have kept proper accounting records
- D To reduce the extent of the alternative procedures which the auditor would otherwise have to undertake

31 The management of Relic Co has refused to provide the auditor with a written management representation that the auditor considers essential in relation to the impairment of a material asset.

Which of the following best describes the impact of this refusal?

- A Prima facie evidence that the financial statements are not presented fairly
- B An illegal act by the directors
- C Grounds for an opinion modified on the basis of material misstatement
- D Grounds for an opinion modified on the basis of insufficient audit evidence

32 The following timetable relates to the audit of a company:

- 31 January – All audit field work completed
- 28 February – Financial statements approved by board of directors
- 5 March – Audit report signed
- 25 April – AGM (Assembly General Meeting) held

What is the most appropriate date for an auditor to obtain a signed written representation from management?

- A 31 January
- B 28 February
- C 4 March
- D 24 April

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33 A large manufacturer has a computerised open-item sales ledger, holding 2,000 customer accounts. The principal files within the system are the customer master file, sales ledger file, and transactions history file.

What audit test could be assisted by a computer enquiry from the sales ledger files against the customer master file?

- A Checking whether customers have exceeded their credit limits
- B Extracting a monetary unit sample of sales invoices
- C Verifying large credit notes
- D Verifying the age analysis of trade receivables

34 **What evidence will inspecting the share certificate, contract note and statutory records of an unquoted investment provide to the auditor?**

- A Existence of the investment
- B Existence and rights and obligations of the investment
- C Existence, rights and obligations, and cost of the investment
- D Existence, rights and obligations, cost and valuation of the investment

35 Pillbox Co makes and sells medical equipment and has a sizeable research and development unit. The directors have identified three material applied research projects whose results they hope will be developed into viable products. They have therefore capitalised the expenditure on these projects and will amortise it over three years. The accounts fully disclose the treatment adopted.

What form should the audit report take?

- A Unmodified
- B Unmodified, with reference to the inherent uncertainty drawing attention to the relevant disclosure note
- C Modified, disclaimer as a result of uncertainty about viability of the products
- D Modified, except for capitalisation of the expenditure

36 **Which of the following forms of evidence is the most reliable where an auditor is unable to physically inspect inventory held by an agent on a sale or return basis?**

- A A copy of the pro-forma invoice to the agent
- B A certificate obtained directly by the auditor from the agent detailing the inventory held on the client's behalf
- C An analysis of cash received from the agent after the year end substantiating the year-end inventory level

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37 An audit objective is stated as “to ensure that all inventory on hand is reflected in the inventory balance at the reporting date”.

Which of the following management assertions should the auditor test?

- A Rights and obligations
- B Valuation and allocation
- C Completeness
- D Existence

38 During their interim audit the auditors discover that there is often a delay between goods being delivered to customers and the subsequent issuance of a sales invoice.

Which test is most likely to establish the extent of any understatement of receivables at the year end?

- A Comparing goods despatch notes issued shortly after the year end with sales records
- B Comparing goods despatch notes issued shortly before the year end with sales records
- C Comparing sales invoices issued shortly before the year end with goods despatched notes
- D A receivables confirmation with a detailed investigation of all reconciling items

39 The managing director of a client company has refused to allow the auditor to write to a major customer who is on the list of receivables selected for direct confirmation, as the customer is a close personal friend who may be offended by the request.

In these circumstances the auditor’s next step would be to

- A Indicate that his refusal constitutes a restriction of scope which will lead to a modification of the audit opinion
- B Perform the circularisation as planned since the auditor’s responsibility is to the members and not the directors
- C Perform the circularisation substituting another receivable with similar characteristics in order to preserve the integrity of the sample
- D Perform the confirmation on the other receivable balances selected and search for alternative audit evidence to confirm the balance of that customer

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40	<p>The financial statements of a manufacturing company do not disclose a loan of \$1,500 made to a director during the year and repaid in full before the year end. The company's profit for the year was \$2million.</p> <p>What reference, if any, should be made to this matter in the audit report?</p> <p>A No reference is necessary</p> <p>B As an except for opinion, giving details of the loan (lack of evidence)</p> <p>C As an except for opinion, giving details of the loan (material misstatement)</p> <p>D An adverse opinion, giving details of the loan</p>
41	<p>Obtaining annual bank confirmation letters and receivable confirmation letters are standard audit procedures. The two forms of letterhead mostly used are:</p> <p>(1) Client's letterhead</p> <p>(2) Auditor's letterhead.</p> <p>On whose letterhead are bank letters and receivable confirmation letters sent?</p> <p>A Both on 1</p> <p>B 1 for the bank letter, 2 for the receivable confirmation</p> <p>C 1 for the receivable confirmation, 2 for the bank letter</p> <p>D Both on 2</p>
42	<p>When auditing a client's year-end cash balance, an auditor uses standard bank confirmations and performs tests on the client's year-end bank reconciliations.</p> <p>Which of the following assertions is tested by these procedures?</p> <p>A Accuracy</p> <p>B Classification</p> <p>C Existence</p> <p>D Rights and obligations</p>
43	<p>Farnham Co has a bank overdraft of \$450,000, secured by a floating charge over its inventory. It also has a deposit with the same bank of \$200,000. The bank confirmation letter states that the bank has the right to off-set these balances, and has set an overall net borrowing limit on the company of \$300,000. The finance director has disclosed these amounts as "secured overdraft – \$250,000" under "current liabilities", with no further description in the notes other than the nature of the security.</p> <p>What steps, if any, should the auditor take in respect of this matter?</p> <p>A None, as the treatment is correct</p> <p>B Insist upon classification of \$200,000 under current assets and \$450,000 under current liabilities</p> <p>C Insist that the company discloses in the notes the full amount of the overdraft and that it is in breach of its borrowing limit</p> <p>D Accept the treatment but include added emphasis in the audit report explaining that</p>

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these amounts have been off-set, and disclosing the overdraft limit

44 **Which of the following procedures is UNLIKELY to provide useful evidence concerning contingent liabilities?**

- A Review of replies received from customers in response to a receivables confirmation
- B Review of board minutes
- C A discussion with the company's legal representatives

45 **What is the appropriate population to select from when using confirmations to provide evidence about the completeness assertion for accounts payable?**

- A Amounts recorded in the payables ledger
- B Invoices filed in the entity's open invoice file
- C Payees of cheques drawn in the month after the reporting date
- D Suppliers with whom the entity has previously done business

46 Under International Standards on Auditing, revenue is identified as being an area of significant risk.

Which financial element of a typical not-for-profit organisation should also be considered a significant risk?

- A Cash
- B Receivables
- C Administration expenses
- D Liabilities

47 **Which statement on internal controls is the most relevant for small entities?**

- A There is a greater need for formal internal controls since segregation of duties will be weaker
- B The same need for formal internal controls is required since the directors' personal involvement is counteracted by weaker segregation of duties
- C There is less need to depend upon formal internal controls since the lower number of transactions will reduce the likelihood of unreliable records and other information
- D Dependence on formal internal controls can be lowered because of the directors' personal involvement in the operation of the entity

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48 ISA 560 *Subsequent Events* sets out the auditor's responsibilities for the period between the year end and the annual general meeting (AGM).

What action is the auditor required to take after signing the audit report and before the AGM?

- A Obtain a representation from the directors that no material events after the reporting period have occurred in that period of time
- B Search for evidence of events after the reporting period that may cause him to change his opinion
- C Consult with the directors on any events after the reporting period of which he becomes aware which might have led him to give a different opinion
- D None, since his responsibilities cease after the audit report is signed

49 On 25 February, an auditor issued an auditor's report expressing an unmodified opinion on financial statements for the year ended 31 January. On 2 March, the auditor learned that on 11 February the entity incurred a material loss on an uncollectible trade receivable. The auditor determined that the financial statements need revision, but management has refused to adjust the financial statements for this subsequent event. There are creditors relying on the financial statements.

What is the auditor's next course of action?

- A To revise the auditor's report and distribute it to the creditors
- B To notify the creditors that the financial statements and auditor's report cannot be relied upon
- C To discuss management's refusal to adjust the financial statements with the board of directors
- D To revise the financial statements and distribute them to the creditors

50 The accounts of Jay Co include a material receivable that management believe will be paid and does not require any allowance. The auditors do not believe that any part of the balance will be paid.

What form should the audit opinion take?

- A Disclaimer
- B Adverse
- C Except for

51 A company's financial statements include an investment of \$45,000 in a company which is in liquidation. It is not yet clear what, if anything, will be recovered. Pending the final report of the liquidators, no allowance has been made in the financial statements. The situation is fully explained in a note to the financial statements. Profit before tax is \$200,000.

What form should the audit opinion take?

- A Adverse
- B Except for – material misstatement
- C Unmodified
- D Disclaimer

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52	Which of the following would you normally characterize as a difficult and complex account to audit? A Property, plant and equipment B Cash C Inventory D Prepaid insurance
53	Which of the following relationships between types of tests and the audit evidence is not correct? A Tests of details and documentation B Tests of Control and Observation C Tests of details and Observation D Substantive tests of transactions and reperformance

TRUE & FALSE (20 %)

1	With respect to audit documentation, working papers should be prepared to enable an experienced auditor with no involvement in the audit to understand the nature, timing, extent and results of the audit procedures performed in the engagement.
2	As a number of deficiencies within the sales cycle are individually not significant, there is no requirement to discuss or report any of them to those charged with governance.
3	The only difference between a management's expert and an auditor's expert is that the management's expert is an employee of the company and the auditor's expert is an employee of the auditor.
4	In order to gather sufficient, appropriate evidence, the auditor may make use of external confirmations. These may take the form of being a positive or negative request. A positive confirmation request for trade receivables always asks respondents to reply to the auditor indicating whether or not they agree with the information provided.
5	Not-for-profit organisations do not need to be audited because they cannot be incorporated.
6	The materiality level calculated at the planning stage should NOT be revised during later stages of the audit
7	Current professional auditing standards prohibit external auditors from using internal auditors for direct assistance on external audits.
8	If an auditor performs a compilation but lacks independence, an additional paragraph must be added which states that: " We are not independent with respect to XYZ Company."

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9	Review reports are normally dated as of the client's balance sheet date.
10	When performing compilation services, the auditor is not required to obtain an understanding of the client's internal control.
11	Current professional auditing standards make it clear that management, not the auditor, is responsible for identifying and deciding the appropriate accounting treatment for contingent liabilities.
12	If an attorney refuses to provide the auditor with information about material existing lawsuits or unasserted claims, current professional standards require that the auditor consider the refusal as a scope limitation.
13	The issuance of bonds by the client subsequent to the balance sheet date would require a footnote disclosure in, but no adjustment to, the financial statements under audit.
14	Auditing standards require the auditor's assessment of going-concern issues.
15	Although the letter of representation is typed on the client's letterhead and signed by the client, it is common for the auditor to prepare the letter.
16	If the client refuses to prepare and sign a letter of representation, the auditor would be required to issue either a qualified opinion or a disclaimer of opinion.
17	If, during the completion phase of the audit, the auditor determines that he or she has not obtained sufficient evidence to draw a conclusion about the fairness of the client's financial statements, there are two choices: accumulate additional evidence or issue either a qualified or an adverse opinion.
18	Auditors are required to communicate either orally or in writing with the audit committee about internal control weaknesses.
19	If an auditor discovers that previously issued financial statements are misleading, the most desirable approach to follow is to request that the client issue an immediate revision of the financial statements containing an explanation of the reasons for the revision.
20	One unique characteristic of the capital acquisition and repayment cycle is that relatively few transactions affect the account balances, but each transaction is often highly material in amount.

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MATCHING (27%)

I - Match nine of the terms (a-i) with the definitions provided below (1-9):

- a. Business risk
- b. Preliminary judgment about materiality
- c. Inherent risk
- d. Planned detection risk
- e. Audit assurance
- f. Acceptable audit risk
- g. Tolerable misstatement
- h. Control risk
- i. Materiality

_____ 1. A measure of the risk that audit evidence for a segment will fail to detect misstatements exceeding a tolerable amount, should such misstatements exist.

_____ 2. The risk that the auditor or audit firm will suffer harm because of a client relationship, even though the audit report rendered for the client was correct.

_____ 3. A measure of the auditor's assessment of the likelihood that misstatements exceeding a tolerable amount in a segment will not be prevented or detected by the client's internal controls.

_____ 4. A measure of how much risk the auditor is willing to take that the financial statements may be materially misstated after the audit is completed and an unqualified audit opinion has been issued.

_____ 5. The materiality allocated to any given account balance.

_____ 6. The maximum amount by which the auditor believes that the statements could be misstated and still not affect the decisions of reasonable users.

_____ 7. This term is synonymous with acceptable audit risk.

_____ 8. The magnitude of an omission or misstatement of accounting information that makes it probable that the judgment of a reasonable person would have been changed.

_____ 9. A measure of the auditor's assessment of the likelihood that there are material misstatements before considering the effectiveness of internal control.

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II - Harker, CPA is in the audit planning phase of Dracule Industries. An understanding needs to be established regarding the responsibilities of Harker and Dracule's Management. For each of the task items listed below indicate the responsible party from the list of choices given. Each choice may be used once, more than once or not at all.

Task to be performed:	Responsible Party:
1. Obtain an understanding of internal controls	a. Auditor is responsible
2. Preparation of the financial statements	b. Management is responsible
3. Assess inherent risk	c. Both are responsible
4. Following IFRS	d. Neither are responsible
5. Establish internal controls	
6. Detect Material Error	
7. Comply with the Country laws and regulations	
8. Assess the risk of the allowance for doubtful accounts estimate	
9. Determine the known and likely errors or misstatements	