I - MULTIPLE CHOICE QUESTIONS (45%)

1. The primary responsibility for the adequacy of disclosure in the financial statements of a publicly held company rests with the

A: Partner assigned to the audit engagement.
B: Management of the company.
C: Auditor in charge of the fieldwork.
D: Securities and Exchange Commission.

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2. In developing a preliminary audit strategy, an auditor should consider

A: Whether the allowance for sampling risk exceeds the achieved upper precision limit.
B: Findings from substantive tests performed at interim dates.
C: Whether the inquiry of the client's attorney identifies any litigation, claims, or assessments not disclosed in the financial statements.
D: The planned assessed level of control risk.

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3. Inherent risk and control risk differ from detection risk in that inherent risk and control risk are

A: Elements of audit risk while detection risk is not.
B: Changed at the auditor's discretion while detection risk is not.
C: Considered at the individual account-balance level while detection risk is not.
D: Functions of the client and its environment while detection risk is not.

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4. A basic premise underlying analytical procedures is that

A: Statistical tests of financial information may lead to the discovery of material misstatements in the financial statements.
B: The study of financial ratios is an acceptable alternative to the investigation of unusual fluctuations.
C: Relationships among data may reasonably be expected to exist and continue in the absence of known conditions to the contrary.
D: These procedures can not replace tests of balances and transactions.

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5. In designing written audit programs, an auditor should establish specific audit objectives that relate primarily to the

A: Timing of audit procedures.
B: Cost-benefit of gathering evidence.
C: Selected audit techniques.
D: Financial statement assertions.

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6. In considering materiality for planning purposes, an auditor believes that misstatements aggregating $10,000 would have a material effect on an entity's income statement, but that misstatements would have to aggregate $20,000 to materially affect the balance sheet. Ordinarily, it would be appropriate to design auditing procedures that would be expected to detect misstatements that aggregate

A: $10,000
B: $15,000
C: $20,000
D: $30,000

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7. A CPA 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.

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8. A LACPA in public practice must be independent in fact and appearance when providing which of the following services?

	Preparation of a tax return	*Compilation of a financial forecast*	*Compilation of personal financial statements*
A	Yes	No	No
B	No	Yes	Yes
C	No	No	Yes
D	No	No	No

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9. Use the audit risk model to calculate audit risk (to the closest percent) in the following circumstance:

40% Control risk
40% Inherent risk
40% Detection risk

A: 1%.
B: 6%.
C: 13%.
D: 40%.

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10. If internal control is properly designed, the same employee should not be permitted to

A: Sign checks and cancel supporting documents.
B: Receive merchandise and prepare a receiving report.
C: Prepare disbursement vouchers and sign checks.
D: Initiate a request to order merchandise and approve merchandise received.

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11. Proper segregation of functional responsibilities calls for separation of the

A: Authorization, approval, and execution functions.
B: Authorization, execution, and payment functions.
C: Receiving, shipping, and custodial functions.
D: Authorization, recording, and custodial functions.

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12. Which of the following procedures would provide the most reliable audit evidence?
A: Inquiries of the client's internal audit staff held in private.
B: Inspection of prenumbered client purchase orders filed in the vouchers payable department.
C: Analytical procedures performed by the auditor on the entity's trial balance.
D: Inspection of bank statements obtained directly from the client's financial institution.

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13. Use the ratio method of sampling to calculate the year-end accounts payable audited balance from the following data:

	Number of accounts	*Book balance*	*Audited balance*
Population	4,100	$5,000,000	?
Sample	200	$ 250,000	$300,000

A: $6,150,000
B: $6,000,000
C: $5,125,000
D: $5,050,000

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14. Which of the following most likely would indicate the existence of related parties?

A: Writing down obsolete inventory just before year-end.
B: Failing to correct previously identified internal control deficiencies.
C: Depending on a single product for the success of the entity.
D: Borrowing money at an interest rate significantly below the market rate.

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15. When auditing related-party transactions, an auditor places primary emphasis on

A: Confirming the existence of the related parties.
B: Verifying the valuation of the related-party transactions.
C: Evaluating the disclosure of the related-party transactions.
D: Ascertaining the rights and obligations of the related parties.

16. The third standard of fieldwork states that sufficient competent evidential matter may, in part, be obtained through inspection, observation, inquiries, and confirmations, to afford a reasonable basis for an opinion regarding the financial statements under examination. The evidential matter required by this standard may, in part, be obtained through

A: Analytical procedures.
B: Auditor working papers.
C: Review of the internal control.
D: Proper planning of the audit engagement.

17. Most of the independent auditor's work in formulating an opinion on financial statements consists of

A: Considering internal control.
B: Obtaining and examining evidential matter.
C: Examining cash transactions.
D: Comparing recorded accountability with assets.

18. Management prepares accounting estimates and the auditor is responsible for evaluating the reasonableness of the estimates. Which of the following would not be an auditor's objective when evaluating estimates?

A: All accounting estimates which could be material to the financial statements have been developed.
B: The accounting estimates developed by management are accurate with 100% certainty.
C: The accounting estimates developed by management are reasonable.
D: The accounting estimates are presented in accordance with International Financial Reporting Standards.

19. Failure to detect material dollar errors in the financial statements is a risk which the auditor primarily mitigates by

A: Performing substantive tests.
B: Performing tests of controls.
C: Assessing internal control.
D: Obtaining a client representation letter.

20. As a result of analytical procedures, the independent auditor determines that the gross profit percentage has declined from 30% in the preceding year to 20% in the current year. The auditor should

A: Include an explanatory paragraph in the audit report due to the inability of the client company to continue as a going concern.
B: Evaluate management's performance in causing this decline.
C: Require footnote disclosure.
D: Consider the possibility of a misstatement in the financial statements.

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21. Analytical procedures used in planning an audit should focus on identifying

A: Material weaknesses in internal control.
B: The predictability of financial data from individual transactions.
C: The various assertions that are embodied in the financial statements.
D: Areas that may represent specific risks relevant to the audit.

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22. Which of the following is least likely to include a reference to the use of a specialist?

A: Unqualified opinion.
B: Adverse opinion.
C: "Except for" qualified opinion.
D: "Subject to" qualified opinion.

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23. As one of the year-end audit procedures, the auditor instructed the client's personnel to prepare a standard bank confirmation request for a bank account that had been closed during the year. After the client's treasurer had signed the request, it was mailed by the assistant treasurer. What is the major flaw in this audit procedure?

A: The confirmation request was signed by the treasurer.
B: Sending the request was meaningless because the account was closed before the year-end.
C: The request was mailed by the assistant treasurer.
D: The CPA did not sign the confirmation request before it was mailed.

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24. Confirmation of individual accounts receivable balances directly with debtors will, of itself, normally provide evidence concerning the

A: Collectibility of the balances confirmed.
B: Ownership of the balances confirmed.
C: Existence of the balances confirmed.
D: Internal control over balances confirmed.

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25. When an auditor concludes there is substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time, the auditor's responsibility is to

A: Prepare prospective financial information to verify whether management's plans can be effectively implemented.
B: Project future conditions and events for a period of time not to exceed 1 year following the date of the financial statements.
C: Issue a qualified or adverse opinion, depending upon materiality, due to the possible effects on the financial statements.
D: Consider the adequacy of disclosure about the entity's possible inability to continue as a going concern.

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26. A material change in an accounting estimate

A: Requires a consistency modification in the auditor's report and disclosure in the financial statements.
B: Requires a consistency modification in the auditor's report but does not require disclosure in the financial statements.
C: Affects comparability and may require disclosure in a note to the financial statements but does not require a consistency modification in the auditor's report.
D: Involves the acceptability of the IFRS Standards used.

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27. How are management's responsibility and the auditor's responsibility represented in the standard auditor's report?

	Management's responsibility	*Auditor's responsibility*
A	Explicitly	Explicitly
B	Implicitly	Implicitly
C	Implicitly	Explicitly
D	Explicitly	Implicitly

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28. As generally conceived, the "audit committee" of a publicly held company should be made up of

A: Representatives of the major equity interests (bonds, preferred stock, common stock).
B: The audit partner, the chief financial officer, the legal counsel, and at least one outsider.
C: Representatives from the client's management, investors, suppliers, and customers.
D: Members of the board of directors who are not officers or employees.

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29. Which of the following representations does an auditor make explicitly and which implicitly when issuing an unqualified opinion?

	Conformity with IFRS	*Adequacy of disclosure*
A	Explicitly	Explicitly
B	Implicitly	Implicitly
C	Implicitly	Explicitly
D	Explicitly	Implicitly

30. Does an auditor make the following representation explicitly or implicitly when issuing the standard auditor's report on comparative financial statements?

	Consistent application of accounting principles	*Examination of evidence on a test basis*
A	Explicitly	Explicitly
B	Implicitly	Implicitly
C	Implicitly	Explicitly
D	Explicitly	Implicitly

II - True or False (10%)

1. 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."

2. The use of positive assurance is appropriate in a review attestation report.

3. An advantage of specific rules in the Code of Professional Conduct is the enforceability of minimum behavior and performance standards.

4. The auditors determine which disclosures must be presented in the financial statements.

5. Audits are expected to provide a higher degree of assurance for the detection of material frauds than is provided for an equally material error.

6. An audit generally provides no assurance that illegal acts that do not have a direct effect on the financial statements will be detected.

7. Under the cycle approach, the only accounts that have two or more cycles associated with them, are cash and accounts receivable.

8. When an auditor is determining what information to include in the notes to the financial

statements relating to bonds payable, he is concerned with the transaction-related audit objectives.

9. For a private company audit, tests of controls are normally performed only on those internal controls the auditor believes have not been operating effectively during the period under audit.

10. When the auditors examine or obtain evidence from third party, they normally assume that the third party is independent of the client.

III - <u>Cases (45%)</u>

1 -Assume you are the partner in charge of the 2012 audit of Becker Corporation, a private company. The audit report has not yet been prepared. In each independent situation following (1-8), indicate the appropriate action (a-g) to be taken. The possible actions are as follows: (8%)

a. Issue a standard unqualified report.
b. Qualify both the scope and opinion paragraphs.
c. Qualify the opinion paragraph.
d. Issue an unqualified opinion with an explanatory paragraph.
e. Issue an unqualified opinion with modified wording (no explanatory paragraph).
f. Issue an adverse opinion.
g. Disclaim an opinion.

The situations are as follows:

________ 1. Becker Corporation carries its property, plant, and equipment accounts at current market values. Current market values exceed historical cost by a highly material amount, and the effects are pervasive throughout the financial statements.

________ 2. Management of Becker Corporation refuses to allow you to observe, or make, any counts of inventory. The recorded book value of inventory is highly material.

________ 3. You were unable to confirm accounts receivable with Becker's customers. However, because of detailed sales and cash receipts records, you were able to perform reliable alternative audit procedures.

________ 4. One week before the end of fieldwork, you discover that the audit manager on the Becker engagement owns a material amount of Becker's common stock.

________ 5. You relied upon another CPA firm to perform part of the audit. Although you were the principal auditor, the other firm audited a material portion of the financial statements. You wish to refer to (but not name) the other firm in your report.

________ 6. You have substantial doubt about Becker's ability to continue as a going concern.

________ 7. Becker Corporation changed its method of computing depreciation in 2012. You concur with the change and the change is properly disclosed in the financial statement footnotes.

________ 8. Ten days after the balance sheet date, one of Becker's buildings was destroyed by a fire. Becker refuses to disclose this information in a footnote to the financial statements, but you believe disclosure is required to conform with IFRS. The amount of the uninsured loss was material, but not highly material.

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2 - In auditing the long-term investments account, Arens, CPA, is unable to obtain audited financial statements for an investee located in a foreign country. The audit manager concludes sufficient appropriate audit evidence regarding this investment cannot be obtained. (15%)

For each of the following situations below, identify the appropriate opinion type and report modification by selecting a choice from the appropriate tables below.

Situation	Opinion Type	Introduction	Scope	Opinion	Exp1
1. Assume the potential effect on the financial statements is immaterial.					
2. Assume the potential effect on the financial statements is moderate.					
3. Assume the potential effect on the financial statements is high.					

Opinion Type	Standard Paragraph Choice	Explanatory Paragraph
U Unqualified	O Omit	0 None required
Q Qualified	N No change	+ Insert before opinion
A Adverse	M Modify	- Insert after opinion
D Disclaimer		

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3 - Match seven of the terms (a-p) with the description/definitions provided below (1-7): (7%)

a. Commitments
b. Completing the engagement checklist
c. Contingent liability
d. Dual-dated audit report
e. Financial statement disclosure checklist
f. Independent review
g. Inquiry of client's attorneys
h. Letter of representation
i. Other information in annual reports
j. Review for subsequent events
k. Subsequent events
l. Unadjusted misstatement worksheet
m. Management letter

n. Pending claim
o. Unasserted claim
p. Audit documentation review

________ 1. A review of the financial statements and the entire set of audit files by an independent reviewer to whom the audit team must justify the evidence accumulated and the conclusions reached.

________ 2. A potential future obligation to an outside party for an unknown amount resulting from activities that have already taken place.

________ 3. A written communication from the client to the auditor formalizing statements that the client has made about matters pertinent to the audit.

________ 4. A potential legal claim against a client where the condition for a claim exists but no claim has been filed.

________ 5. Transactions that occurred after the balance sheet date, which affect the fair presentation or disclosure of the statements being audited.

________ 6. Agreements that the entity will hold to a fixed set of conditions, such as the purchase or sale of merchandise at a stated price.

________ 7. The use of one audit report date for normal subsequent events and a later date for one or more subsequent events.

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4 - You are the audit senior in charge of the audit of Swandive Co (Swandive), and have been informed by your audit manager that during the year a fraud occurred at the client. A payroll clerk set up fictitious employees and the wages were paid into the clerk's own bank account. This clerk has subsequently left the company, but the audit manager is concerned that additional frauds have taken place in the wages department.

Required:
State in bullet points procedures which should be undertaken during the audit of wages as a result of the manager's assessment of the increased risk of fraud. (7%)

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5 - Match the terms (a-k) with the definitions provided below (1-4) (8%)

a. Haphazard selection
b. Attributes sampling
c. Block sample selection
d. Judgmental sampling
e. Non-probabilistic sample selection
f. Probabilistic sample selection
g. Random sample
h. Representative sample
i. Statistical sampling
j. Systematic sample selection
k. Sampling distribution

______ 1. The use of mathematical measurement techniques to calculate formal statistical results and quantify sampling risk.

______ 2. A non-probabilistic method of sample selection in which items are selected in measured sequences.

______ 3. A sample whose characteristics are the same as those of the population.

______ 4. A statistical, probabilistic method of sample evaluation that results in an estimate of the proportion of items in a population containing a characteristic of interest.