

A. MULTIPLE CHOICE QUESTIONS (30%)

1. 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

2. Which TWO of the following statements regarding the use of analytical procedures during the PLANNING stage of the audit are correct?
(1) Analytical procedures are useful when forming an overall conclusion as to whether the financial statements are consistent with the auditor's understanding of the company
(2) Analytical procedures can be used to obtain relevant and reliable audit evidence
(3) Analytical procedures can assist in identifying the risks of material misstatement
(4) Analytical procedures can assist in identifying unusual transactions and events
 - A. 1 and 2
 - B. 2 and 3
 - C. 3 and 4
 - D. 2 and 4

3. 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 nature
 - C. For assets disposed of, agree the sale proceeds to supporting documentation and cash book

4. A qualified opinion can be issued for which of the following?
 - I. When a limitation on the scope of the audit has occurred
 - II. When the auditor lacks independence
 - III. When generally accepted accounting principles have not been used
 - A. I and II
 - B. I and III
 - C. II and III
 - D. I, II and III

5. **According to the Principles section of the Code of Professional Conduct, all members:**
- A. should be independent in fact and in appearance at all times.
 - B. in practice should be independent in fact and in appearance at all times.
 - C. in practice should be independent in fact and in appearance when providing auditing and other attestations services.
 - D. in practice should be independent in fact and in appearance when providing auditing, tax, and other attestation services.
6. **Which of the following loans would be prohibited between the auditor and an his audit client?**
- A. Automobile loans
 - B. Loans fully collateralized by cash deposits at the same financial institution
 - C. New home mortgage loans
 - D. Unpaid credit card balances not exceeding \$10,000 in total
7. **The responsibility for the preparation of the financial statements and the accompanying disclosures belongs to:**
- A. the auditor.
 - B. management.
 - C. both management and the auditor equally.
 - D. management for the statements and the auditor for the notes.
8. **A client high-tec company has financial problems, a dominant chief executive, poor internal control and unusual transactions. What are all of these factors indicative of?**
- A. Inadequacies in the systems of reporting
 - B. The presence of going concern problems
 - C. Increased scope for potential fraud
 - D. Increased audit risk
9. **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. Which of the following types of audit procedures do these actions illustrate?**
- A. Inquiry and inspection of records
 - B. Confirmation and reperformance
 - C. Analytical procedures and reperformance
 - D. Observation and inspection of records

10. **Which of the following would cause an auditor to perform tests of controls after obtaining an understanding of the entity and its environment?**
- 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
11. **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
12. **When using the cycle approach to segmenting the audit, the reason for treating capital acquisition and repayment separately from the acquisition of goods and services is that:**
- A. the transactions are related to financing a company rather than to its operations.
 - B. most capital acquisition and repayment cycle accounts involve few transactions, but each is often highly material and therefore should be audited extensively.
 - C. both A and B are correct.
 - D. neither A nor B is correct.
13. **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:**
- (1) Harry, a director of Aaron Co, owes \$1,000 to the company (borrowed during the year).
 - (2) Sundry income of \$35,000
- Which of the two items should be tested?**
- A. Neither 1 nor 2
 - B. Both 1 and 2
 - C. 1 only
 - D. 2 only
14. **Which audit tests involve physical examination and confirmation?**
- A. Tests of controls
 - B. Tests of transactions
 - C. Tests of balances
 - D. Analytical procedures
15. **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.

16. **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.
17. **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. To whom does the auditor have a primary duty to report this matter to?**
- A. Those charged with governance
 - B. The company's shareholders
 - C. The tax authorities
18. **Which of the following audit procedures for obtaining audit evidence is correctly described?**
- A. Recalculation involves the auditor's independent execution of procedures or controls which were originally performed as part of the entity's internal control
 - B. Confirmation consists of seeking information of knowledgeable persons, within the company or outside the company
 - C. Reperformance consists of checking the mathematical accuracy of documents or records
 - D. Observation consists of looking at a procedure or process being performed by others
19. **Auditors are required to undertake an overall review of the financial statements as the final step before they form their audit opinion. As part of this process they undertake a number of procedures. Which of the following procedures would an auditor NOT undertake as part of the overall review of the financial statements?**
- A. Reviewing the financial statements to ensure they are consistent with the auditor's knowledge of the business and the results of their audit work
 - B. Performing analytical procedures on the financial statements to form an overall conclusion on the financial statements
 - C. Undertaking a review of subsequent events to identify whether any adjustment or disclosure is required in the financial statements
 - D. Reviewing the financial statements to ensure compliance with accounting standards and local legislation Disclosure
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.

B. Exercises

Exercise # 1 (12%)

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. Some actions could be used more than once OR not to be used at all. The possible actions are as follows:

- 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.

Exercise # 2 (14%)

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.

Exercise # 3 (14%)

Grains 4U Co (Grains) manufactures breakfast cereals and has three factories, four warehouses and three distribution depots spread across North America. The audit for the year ended 31 December 2015 is almost complete and the financial statements and audit report are due to be signed shortly.

Profit before taxation is \$7.9 million. The following events have occurred subsequent to the year end and no amendments or disclosures have been made in the financial statements.

Event 1 – Fire

On 15 February 2016, a fire occurred at the largest of the distribution depots. The fire resulted in extensive damage to 40% of the company's vehicles used for dispatching goods to customers; however, there have been no significant delays to customer deliveries. The company estimates the level of damage to the vehicles to be in excess of \$650,000. Only a minimal level of inventory, approximately \$25,000, was damaged. Grain's insurance company has started to investigate the fire to assess the likelihood and level of payment, however, there are concerns the fire was started deliberately, and if true, would invalidate any insurance cover.

Event 2 – Inventory

On 18 February 2016, it was discovered that a large batch of Grain's new cereal brand 'Loopy Green Loops' held in inventory at the year-end was defective, as the cereal contained too much green food colouring. To date no sales of this new cereal have been made. The cost of the defective batch of inventory is \$915,000 and the defects cannot be corrected. However, the scrapped cereal can be utilised as a raw material for an alternative cereal brand at a value of \$50,000.

Required:

For each of the two subsequent events described above:

(i) Based on the information provided, explain whether the financial statements require amendment; and

(ii) Describe audit procedures which should now be performed in order to form a conclusion on any required amendment.

Exercise # 4 (30%)

Comet Publishing Co

You are an audit supervisor of Halley & Co and you are reviewing the documentation describing Comet Publishing Co's purchases and payables system in preparation for the interim and final audit for the year ending 30 September 20X7. The company is a retailer of books and has ten stores and a central warehouse, which holds the majority of the company's inventory

Your firm has audited Comet Publishing Co for a number of years and as such, audit documentation is available from the previous year's file, including internal control flowcharts and detailed purchases and payables system notes. As far as you are aware, Comet Publishing Co's system of internal control has not changed in the last year. The audit manager is keen for the team to utilise existing systems documentation in order to ensure audit efficiency. An extract from the existing systems notes is provided below.

Extract of purchases and payables system

Store managers are responsible for ordering books for their shop. It is not currently possible for store managers to request books from any of the other nine stores. Customers who wish to order books,

which are not in stock at the branch visited, are told to contact the other stores directly or visit the company website. As the inventory levels fall in a store, the store manager raises a purchase requisition form, which is sent to the central warehouse. If there is insufficient inventory held, a supplier requisition form is completed and sent to the purchase order clerk, Oliver Dancer, for processing. He sends any orders above \$1,000 for authorisation from the purchasing director.

Receipts of goods from suppliers are processed by the warehouse team, who agree the delivery to the purchase order, checking quantity and quality of goods and complete a sequentially numbered goods received note (GRN). The GRNs are sent to the accounts department every two weeks for processing.

On receipt of the purchase invoice from the supplier, an accounts clerk matches it to the GRN. The invoice is then sent to the purchase ordering clerk, Oliver, who processes it for payment. The finance director is given the total amount of the payments list, which she authorises and then processes the bank payments. Due to staff shortages in the accounts department, supplier statement reconciliations are no longer performed.

Other information- conflict of interest

Halley & Co has recently accepted the audit engagement of a new client, Edmond Co, who is the main competitor of Comet Publishing Co. The finance director of Comet Publishing Co has enquired how Halley & Co will keep information obtained during the audit confidential.

Required:

(a) Explain the safeguards which Halley & Co should implement to ensure that the identified conflict of interest is properly managed.

(b) Explain the steps the auditor should take to confirm the accuracy of the purchases and payables flowcharts and systems notes currently held on file.

(c) In respect of the purchases and payables system for Comet Publishing Co :
(i) Identify and explain FIVE deficiencies

(ii) Recommend a control to address each of these deficiencies, and

(iii) Describe a TEST OF CONTROL the auditor should perform to assess if each of these controls, if implemented, is operating effectively to reduce the identified deficiency.

Note: Prepare your answer using three columns headed Control deficiency, Control recommendation, and Test of control respectively.

deficiencies of Control	Recommendation	Test of Control
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(d) Describe substantive procedures the auditor should perform to obtain sufficient and appropriate evidence in relation to Comet Publishing Co's purchases and other expenses.

Good Work!!