

**A. MULTIPLE CHOICE QUESTIONS (20%)**

- 1. The most favorable type of audit report opinion for the client to receive is:**
  - A. Qualified.
  - B. Unqualified.
  - C. Full assurance.
  - D. Exceptional.
  
- 2. Which of the following is generally not considered one of the five business processes or cycles?**
  - A. Information technology
  - B. Revenue [or sales]
  - C. Financing
  - D. Inventory management
  
- 3. Which of the following management assertions is generally of greatest importance in the audit of inventory?**
  - A. Existence
  - B. Completeness
  - C. Rights and Obligations
  - D. Presentation and Disclosure
  
- 4. Which of the following conditions or events most likely would cause an auditor to have substantial doubt about an entity's ability to continue as a going concern?**
  - A. Cash flows from operating activities are negative
  - B. Research and development projects are postponed
  - C. Significant related party transactions are pervasive
  - D. Stock dividends replace annual cash dividends
  
- 5. An auditor who qualifies an opinion because of an insufficiency of evidential matter should describe the limitations in an explanatory paragraph. The auditor should also refer to the limitation in the**

<u>Scope paragraph</u>	<u>Opinion paragraph</u>	<u>Notes to the financial statements</u>
A. Yes	No	Yes
B. No	Yes	No
C. Yes	Yes	No
D. Yes	Yes	Yes

- 6. Only \_\_\_\_\_ involve physical examination and confirmation.**
  - A. tests of controls
  - B. tests of transactions
  - C. tests of balances
  - D. analytical procedures

- 7. An auditor tests account receivable for completeness by**
- A. Confirmation.
  - B. Preparing an aging schedule.
  - C. Testing inventory shipping cutoffs.
  - D. Inquiring as to the pledging of inventories.
- 8. An effective system of internal control requires segregation of basic functions (segregation of duties).**
- Which THREE of the following functions should ideally be segregated?**
- (1) Authorisation of transactions
  - (2) Preparation of financial statements
  - (3) Custody or handling of assets
  - (4) Budgetary control
  - (5) Recording of transactions
- A. 1, 3 and 5
  - B. 1, 2 and 3
  - C. 1, 2 and 5
  - D. 3, 4 and 5
- 9. 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
- 10. 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

**A. True OR False (15%)**

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. 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.
4. Current professional auditing standards prohibit external auditors from using internal auditors for direct assistance on external audits.
5. 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."
6. Review reports are normally dated as of the client's balance sheet date.
7. 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.
8. Auditing standards require the auditor's assessment of going-concern issues.
9. 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.
10. 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

**Read the following scenario and answer the below:**

**Audit planning involves developing an overall strategy for the expected conduct and scope of the audit and involves auditor consideration of a number of matters.**

**For each of items 1 through 5 listed below, indicate whether the item is TRUE in that it is normally a planning procedure, or FALSE if it is not normally a planning procedure.**

11. Select accounts to be confirmed.

12. Identify financial statement items likely to require adjustment.
13. Consider the nature of the audit reports expected to be rendered.
14. Consider the risk of the existence of related party transactions.
15. Consider the risk of the existence of reportable controls.

## **B. Exercises**

### **Exercise 1 ( 30%)**

Jasmine Co manufactures motor vehicle components and its year end was 30 June 20X8. You are an audit supervisor of Peppermint & Co and the final audit is due to commence shortly. Total assets are \$43.2m and profit before tax is \$7.2m. The following matters have been brought to your attention:

#### **Trade receivables**

Jasmine Co's trade receivables ledger is comprised of a large number of customers. In previous years, the audit

team has undertaken a positive trade receivables circularisation to confirm year-end balances.

However, the customer response rate has historically been low and so alternative audit procedures have been undertaken. A decision has been made that for the current year audit a circularisation will not be performed. The year-end trade receivables balance is \$3.9m (20X7: \$2.8m) and the allowance for trade receivables is \$410,000 (20X7: \$300,000).

#### **Bank balances**

The bank and cash figure included in Jasmine Co's draft financial statements is comprised of a number of bank account balances: an overdraft of \$5.1m which is the company's main current account and \$0.2m relating to several savings accounts. The finance director has informed the audit manager that all accounts have been reconciled as at the year end.

The overdraft of \$5.1m has increased significantly since the prior year (20X7: \$1.2m). The directors have informed you that the overdraft facility, which the company requires in order to operate on a daily basis, is due for renewal in October 20X8 and that they are confident it will be renewed.

#### **Required:**

**(a) Describe substantive procedures the auditor should perform to obtain sufficient and appropriate audit evidence in relation to Jasmine Co's trade receivables.**

**(b) Describe substantive procedures the auditor should perform to obtain sufficient and appropriate audit evidence in relation to Jasmine Co's bank balances.**

**(c) Describe the audit procedures the auditor should perform in assessing whether or not Jasmine Co is a going concern.**

During the final audit, the finance director has informed the audit team that Jasmine Co’s bankers will not make a decision on the renewal of the overdraft facility until after the auditor’s report is signed. The audit engagement partner is satisfied that the use of the going concern basis is appropriate. The directors have agreed to include some brief going concern disclosures in the draft financial statements and the audit team still have to assess the adequacy of these disclosures.

**Required:**

**(d) Discuss the issue and describe the impact on the auditor’s report of Jasmine Co of adequate AND inadequate going concern disclosure.**

**Exercise2 (15%)**

**Read the following scenario and answer the below:**

You are an audit manager in Tigger &Co, a large audit firm which specializes in the audit of car manufacturers. The firm currently audits Winne Co. Winnie Co.’s main competitor, Piglet Co, has approached Tigger &Co to act as auditor. The audit engagement partner for Winnie Co has been in place for seven years. Winnie Co has approached Tigger &Co to provide internal audit services as well as the external audit.

1. Which of the following statements is False in respect of the audits of Winnie Co and Piglet Co?
  - a. Tigger &Co will have a good understanding of the car manufacturing industry making them a good choice of firm for both companies.
  - b. Winne Co and Piglet Co may be concerned that commercially sensitive information may be disclosed by Tigger &Co to their competitor.
  - c. Tigger &Co must ask permission of the LACPA before accepting the audit of Piglet Co.
  - d. Tigger &CO may obtain consent of both clients before continuing with the engagements.
  
2. Which of the following is NOT an action that your firm should take to manage the conflict of interest between Winnie Co and Piglet Co?
  - a. Regular monitoring of safeguards by an engagement quality control reviewer.
  - b. Require every employee of Tigger &CO to sign a confidentiality agreement.
  - c. Use separate engagement teams with different engagement partners.
  - d. Operate secure data filing of all audit information.
  
3. Select whether the following statements are true or false in respect of the audit of Winnie Co. knowing that they have suggested that the external audit fee should be renegotiated with at least 20% of the fee being based on the profit after tax of the company as they feel that this will align the interests of Tigger &Co and Winne Co.

	TRUE	FALSE
The audit partner must be rotated		
The proposal of 20% of the audit fee being based on profit is acceptable if appropriate safeguards are implemented		
Being appointed as internal auditor as well external auditor for Winnie CV will create a confidentiality threat.		

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4. For which TWO of the following situations must an auditor make disclosure of confidential information?
- a. If an auditor knows or suspects his client is engaged in money laundering.
  - b. Where disclosure is made to non-governmental bodies.
  - c. When the client has given permission.
  - d. If an auditor suspects his client has committed terrorist offences.

**Exercise 3 (20%)**

A financial statement audit typically consists of four phases. Identify each of these four phases of an audit and discuss the major activities performed by the auditor in each phase.

***Good Work!!***