

MULTIPLE CHOICE QUESTIONS (40%)

1) When qualifying an opinion because of an insufficiency of audit evidence, an auditor should refer to the situation in the

	<u>Opinion (introductory)</u> <u>paragraph</u>	<u>Scope</u> <u>paragraph</u>
A.	NO	NO
B.	YES	NO
C.	YES	YES
D.	NO	YES

2) An auditor issued an audit report that was dual dated for a subsequent event occurring after the completion of fieldwork but before issuance of the auditor's report. The auditor's responsibility for events occurring subsequent to the completion of fieldwork was

- A. Limited to include only events occurring up to the date of the last subsequent event referenced
- B. Limited to the specific event referenced
- C. Extended to subsequent events occurring through the date of issuance of the report
- D. Extended to include all events occurring since the completion of fieldwork

3) In which of the following situations would an auditor ordinarily choose between expressing a qualified opinion or an adverse opinion?

- A. The auditor did not observe the entity's physical inventory and is unable to become satisfied about its balance by other auditing procedures
- B. Conditions that cause the auditor to have substantial doubt about the entity's ability to continue as a going concern are inadequately disclosed
- C. There has been a change in accounting principles that has a material effect on the comparability of the entity's financial statements
- D. The auditor is unable to apply necessary procedures concerning an investor's share of an investee's earnings recognized on the equity method

4) Which of the following is an element of an audit firm's quality control system that should be considered in establishing its quality control policies and procedures?

- A. Complying with laws and regulations
- B. Using statistical sampling techniques
- C. Assigning personnel to engagements
- D. Considering audit risk and materiality

- 5) **On the basis of audit evidence gathered and evaluated, an auditor decides to increase the assessed level of control risk from that originally planned. To achieve an overall audit risk level that is substantially the same as the planned audit risk level, the auditor would**
- A. Decrease substantive testing
 - B. Decrease detection risk
 - C. Increase inherent risk
 - D. Increase materiality levels
- 6) **Proper segregation of duties reduces the opportunities to allow persons to be in positions to both**
- A. Journalize entries and prepare financial statements
 - B. Record cash receipts and cash disbursements
 - C. Establish internal controls and authorize transactions
 - D. Prepare and conceal errors and fraud
- 7) **While observing a client's annual physical inventory, an auditor recorded test counts for several items and noticed that certain test counts were higher than the recorded quantities in the client's perpetual records. This situation could be the result of the client's failure to record**
- A. Purchase discounts
 - B. Purchase returns
 - C. Sales
 - D. Sales returns
- 8) **Which of the following is an audit procedure that an auditor most likely would perform concerning litigation, claims, and assessments?**
- A. Request the client's lawyer to evaluate whether the client's pending litigation, claims, and assessments indicate a going concern problem
 - B. Examine the legal documents in the client's lawyer's possession concerning litigation, claims, and assessments to which the lawyer has devoted substantive attention
 - C. Discuss with management the controls adopted for evaluating and accounting for litigation, claims, and assessments
 - D. Confirm directly with the client's lawyer that all litigation, claims, and assessments have been recorded or disclosed in the financial statements

- 9) Which of the following sets of duties would ordinarily be considered a weakness in internal control?**
- A. Preparation of monthly statements to costumers and maintenance of the accounts receivable subsidiary ledger
 - B. Posting to the general ledger and approval of additions and terminations relating to the payroll
 - C. Custody of unpaid signed checks and maintenance of expense subsidiary ledgers
 - D. Collection of receipts on account and maintaining accounts receivable records
- 10) The amount of substantive tests and the effectiveness of internal control vary in a relationship that is ordinarily**
- A. Parallel
 - B. Inverse
 - C. Direct
 - D. Equal
- 11) In determining the type of opinion to express, an auditor assesses the nature of the reporting qualifications and the materiality of their effects. Materiality will be the primary factor considered in the choice between**
- A. An “except for” opinion and an adverse opinion
 - B. An “except for” opinion and a “subject to” opinion
 - C. An adverse opinion and a disclaimer of opinion
 - D. A “subject to” opinion and a piecemeal opinion
- 12) Which of the following factors is most important in determining the competence of audit evidence?**
- A. The reliability of the evidence in meeting the audit objective
 - B. The objectivity of the auditor gathering the evidence
 - C. The quantity of the evidence obtained
 - D. The independence of the source of evidence
- 13) In testing for cutoff, the objective is to determine:**
- A. Whether all of the current period’s transactions are recorded
 - B. Whether transactions are recorded in the correct accounting period
 - C. The proper cutoff between capitalizing and expensing expenditures
 - D. The proper cutoff between disclosing items in footnotes or in account balances

- 14) The primary objective of an auditor's observation of a client's physical inventory count is to**
- A. discover whether a client has counted a particular inventory item or group of items
 - B. obtain direct knowledge that the inventory exists and has been properly counted
 - C. provide an appraisal of the quality of the merchandise on hand on the count day
 - D. allow the auditor to supervise the conduct of the count so as to obtain assurance that inventory quantities are reasonably accurate
- 15) Which of the following types of engagement performed by a public accountant provides a report that contains negative assurance?**
- A. Audit
 - B. Review
 - C. Compilation
 - D. None of the above
- 16) Which of the following information-gathering activities or attention-directing activities is not a form of analytical procedure?**
- A. Reading and studying the company minutes
 - B. Reviewing prior year's file for adjustments made
 - C. Comparing current year's salaries to prior year's
 - D. Recalculating the amortization of equipment
- 17) What does "off the balance sheet" mean?**
- A. Obligations and commitments are not recorded in the accounts of the company.
 - B. Obligations and commitments are recorded, but in the income statement accounts.
 - C. Obligations and commitments are recorded, but in the Statement of Changes in Financial Position.
 - D. Capital budgets are properly authorized and approved.
- 18) Which of the following would be a consideration in planning an auditor's sample for a test of controls?**
- A. Preliminary judgments about materiality levels.
 - B. The auditor's allowable risk of assessing control risk too high.
 - C. The level of detection risk for the account.
 - D. The auditor's allowable risk of assessing control risk too low.

- 19) Which of the following actions should an accountant take when engaged to compile a company's financial statements in accordance with Statements on Standards for Accounting and Review Services (SSARS)?**
- A. Perform analytical procedures.
 - B. Express negative assurance on the financial statements.
 - C. Make management inquiries and examine internal controls.
 - D. Perform the engagement even though independence is compromised.
- 20) A client is a defendant in a patent infringement lawsuit against a major competitor. Which of the following items would least likely be included in the attorney's response to the auditor's letter of inquiry?**
- A. A description of potential litigation in other matters or related to an unfavorable verdict in the patent infringement lawsuit.
 - B. A discussion of case progress and the strategy currently in place by client management to resolve the lawsuit.
 - C. An evaluation of the probability of loss and a statement of the amount or range of loss if an unfavorable outcome is reasonably possible.
 - D. An evaluation of the ability of the client to continue as a going concern if the verdict is unfavorable and maximum damages are awarded.
- 21) Which of the following items would most likely require an adjustment to the financial statements for the year ended December 31, year 1?**
- A. Uninsured loss of inventories purchased in year 1 as a result of a flood in year 2.
 - B. Settlement of litigation in year 2 over an event that occurred in year 2.
 - C. Loss on an uncollectible trade receivable recorded in year 1 from a customer that declared bankruptcy in year 2.
 - D. Proceeds from a capital stock issuance in year 2 which was being approved by the board of directors in year 1.
- 22) Evidence concerning the proper segregation of duties for receiving and depositing cash receipts ordinarily is obtained by:**
- A. Completing an internal control questionnaire that describes the control activities.
 - B. Observing the employees who are performing the control activities.
 - C. Performing substantive tests to verify the details of the bank balance.
 - D. Preparing a flow chart of the duties performed and the entity's available personnel.

- 23) In assessing the competence of internal auditors, an independent CPA most likely would obtain information about the:**
- A. Influence of management on the scope of the internal auditors' duties.
 - B. Policies limiting internal auditors from communicating with the audit committee.
 - C. Quality of the internal auditors' working paper documentation.
 - D. Entity's ability to continue as a going concern for a reasonable period of time.
- 24) An auditor believes that there is substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time. In evaluating the entity's plans for dealing with the adverse effects of future conditions and events, the auditor most likely would consider, as a mitigating factor, the entity's plans to:**
- A. Extend the due dates of existing loans.
 - B. Operate at increased levels of production.
 - C. Accelerate expenditures for research and development projects.
 - D. Issue stock options to key executives.
- 25) The internal auditor typically reports directly to**
- A. the management of the company.
 - B. the audit committee and the management of the company.
 - C. the audit committee and the board of director.
 - D. the board of director and the external auditor
- 26) The responsibility for the preparation of the financial statements and the accompanying footnotes belongs to**
- A. both management and the auditor equally.
 - B. management for the statements and the auditor for the notes.
 - C. the auditor.
 - D. management.
- 27) Frankfurter Limited decided that it wanted to improve earnings. To do this, they understated their expenses by omitting unpaid expenses from the accrued liabilities account at year end. Which management assertion has been violated?**
- A. rights and obligations
 - B. completeness
 - C. existence
 - D. disclosure

- 28) The audit risk model is used primarily**
- A. while doing tests of controls.
 - B. to determine the type of opinion to express.
 - C. for planning purposes in determining how much evidence to accumulate.
 - D. to evaluate the evidence which has been gathered.
- 29) The risk that an auditor's procedures will lead to the conclusion that a material misstatement does not exist in an account balance when, in fact, such misstatement actually does exist is**
- A. Audit risk
 - B. Sampling risk.
 - C. Control risk.
 - D. Detection risk.
- 30) On the basis of audit evidence gathered and evaluated, an auditor decides to increase the assessed level of control risk from that originally planned. To achieve an overall audit risk level that is substantially the same as the planned audit risk level, the auditor would**
- A. Decrease substantive testing.
 - B. Increase substantive testing.
 - C. Increase inherent risk.
 - D. Increase materiality.
- 31) Which of the following considerations of fraud and error by the auditor is not required by ISA 240?**
- A. The auditor should be satisfied that those charged with governance have been informed of any material weaknesses in internal control related to the prevention and detection of fraud
 - B. When the auditor encounters circumstances that may indicate that there is a material misstatement in the financial statements resulting from fraud or error, the auditor should inform regulatory institutions
 - C. The auditor should communicate to management any material weaknesses in internal control related to the prevention or detection of fraud and error
 - D. Based on the risk assessment the auditor should design audit procedures to obtain reasonable assurance that material misstatements arising from fraud and error are detected
- 32) A written request which asks the recipient (debtor, creditor, or other third party) to confirm agreement or asks the respondent to fill in information is called a:**
- A. Management representation letter

- B. Positive confirmation
- C. Customer letter
- D. Negative confirmation

33) The IFAC Code prohibits the following non-audit service for audit clients:

- A. Valuation services
- B. Outsourcing of internal audit function
- C. Actuarial services
- D. Information technology systems services

34) Financial involvement with a client will affect independence and may lead a reasonable observer to conclude that independence has been impaired. Which of the following is not a form of financial involvement with a client?

- A. Financial interest resulting from being an administrator of any trust with a financial interest in the client
- B. Financial interest in a joint venture with a client
- C. Fees paid for audit engagement
- D. Loans to or from the client

35) Steven asked his client for a list of all inventory held off-site at B's Storage Inc. The client advised him that it had signed an agreement with the owner of B's Storage that would not permit an outside auditor to review its records due to privacy concerns, and the storage facility was not accessible because the owner was on an extended vacation. Therefore, verification of the inventory assertions. would have to be by confirmation only. Steven was able to satisfy himself using other procedures as to the management assertions concerning the inventory. Which of the following describes this situation?

- A. A denial of opinion is required.
- B. Either a denial or a qualified opinion is required.
- C. Either an adverse or a denial of opinion is required.
- D. An unqualified opinion is possible.

36) A challenge associated with the Ethical Principles stated in the *Code of Professional Conduct* is:

- A- the emphasis on positive activities
- B- that they identify ideal conduct
- C- the difficulty of enforcing principles, or general ideals
- D- that there are too many to remember

37) Which one of the following is not the primary purpose of audit documentation?

- A- a basis for planning the audit.
- B- a record of the evidence accumulated and the results of the tests.
- C- a basis for review by supervisors and partners.
- D- a basis for determining work deficiencies by peer review teams.

38) Which of the following is not one of the three primary objectives of effective internal control?

- A- reliability of financial reporting.
- B- efficiency and effectiveness of operations.
- C- compliance with laws and regulations.
- D- assurance of elimination of business risk.

39) Shown below (1 through 5) are the five types of tests which auditors use to determine whether financial statements are fairly stated. Which three are substantive tests?

1. procedures to obtain an understanding of internal control
2. tests of controls
3. tests of transactions
4. analytical procedures
5. tests of details of balances

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

40) When the auditor decides to select less than 100 percent of the population for testing, the auditor is said to use:

- A- audit sampling
- B- representative sampling
- C- poor judgment
- D- estimation sampling

TRUE & FALSE (10%)

1) Materiality is the concept that information is material and needs to be disclosed to users if it is likely to not influence the economic decisions of financial statement users

A) True

B) False

2) When an auditor assesses control risk at a maximum, it means that the auditor feels the internal controls really work

A) True

B) False

3) Use of positive confirmations provides better audit evidence than use of negative confirmations.

A) True

B) False

4) The bank reconciliation should be done by someone other than the accountant, such as the office manager or administrative assistant.

A) True

B) False

5) If an auditor determines that during the course of an audit several adjusting entries need to be made to enable the financial statement to not be materially misstated, he should make the necessary changes.

A) True

B) False

6) The legal letter and client representation letter are procedures that can easily be done at interim in order to save time at yearend.

A) True

B) False

7) Management letters which are addressed to management are required by auditing standards.

A) True

B) False

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8) Substantive procedures give direct evidence about the financial amounts reported in the financial statements.

A) True

B) False

9) Spoken and written representations given by the auditee's officers, directors, owners, and employees are generally considered reliable enough to stand on its own.

A) True

B) False

10) An adverse opinion in an audit report refers to when there is a departure from IFRS that is material.

A) True

B) False

11) A disclaimer of opinion in an audit report refers to when there is a departure from IFRS that is material.

A) True

B) False

12) When independence in an audit is lacking, an auditor should not accept the engagement.

A) True

B) False

13) The permanent file contains information that can be used year over year for the same client.

A) True

B) False

14) The purpose of assessing control risk is to enable the auditor to design internal controls to help management.

A) True

B) False

15) All substantive tests can be performed before the end of the year under audit.

A) True

B) False

16) Audit procedures on the sample item will not vary as a result of using either statistical or nonstatistical sampling.

A) True

B) False

17) Inherent risk relates to the nature, timing, and extent of evidence that the auditor gathers to test assertions that relate to account balances and disclosures in the financial statements.

A) True

B) False

18) All audit procedures require the use of audit sampling.

A) True

B) False

19) If after delivering an audit report an auditor determines that a necessary audit procedure was omitted, he or she should perform it in the next audit.

A) True

B) False

20) The auditor analyzes property additions to determine if they are complete.

A) True

B) False

SMALL ESSAY QUESTIONS (30%)

Answer the following

I. Explain the purpose of testing the client's bank reconciliation, and discuss **five** audit procedures involved.

II.

A. Tell whether each of the following is fraud or error:

----- Mathematical or clerical mistakes in collecting or processing.

----- Misapplication of accounting policies.

----- Suppression or omission of effects of transactions from records of documents.

B. Give five factors that could affect the auditor's ability to detect fraud

III - Numbering the stages of an audit process from 1 to 9:

_____ Obtain management representations

_____ Substantive work

_____ Planning

_____ Control effectiveness

_____ Engagement letter

_____ Review and finalization procedures

_____ Understanding internal controls

_____ Assess risk

_____ Sign auditor's report

IV - Roudaina is a LACPA with an accounting practice in a small town. She obtained her accounting designation 25 years ago and is now thinking of retiring in the next 5 years. In order to make her practice more valuable, she has decided to branch out into auditing. Roudaina doesn't want to take refresher courses just to do a few audits, so she decided to restrict her audit practice to companies owned by friends. Her first audit is Riad's Repair Inc., owned by her brother. Riad owns all of the shares of the company, and the audited financial statements will only be used by creditors who have already lent money to the company. Riad agreed to the audit to help Roudaina to establish her auditing practice. Roudaina agreed to hire Riad's daughter to help review the inventory. Roudaina and Riad agreed that her fee would be \$8,000 whether or not problems were encountered, but with a bonus if an unqualified report could be issued.

Required

Indicate *four* violations in the above scenario.

V- You are an audit manager currently finalising your 31 December 2008 audits. The following independent and material matter have come to your attention from Shark Ltd, a reporting entity, uses the last-in first-out basis in respect of valuation of closing inventory, which is one of the most significant balance sheet accounts.

The difference between first-in first-out and last-in-first-out has a material effect on the closing inventory balance.

Required

Discuss the audit issues to be considered and their likely impact on the audit opinion to be issued. Justify your answer.

VI - Match the assertion with the most appropriate audit procedure:

- Completeness
- Existence
- Presentation and disclosure
- Rights and obligations
- Valuation and allocation

- a. Confirm accounts receivable and perform alternative procedures for confirmations not returned _____
- b. Obtain last bill of lading for the period and determine that all shipments were recorded _____
- c. Review minutes of the board of director's meetings, inquire of client, read contracts and agreements, and confirm with lenders any indications that accounts have been assigned, sold, or pledged _____
- d. Review the financial statements and perform analytical procedures to determine whether accounts are classified and disclosed in accordance with International Financial Reporting Standards _____
- e. Test the adequacy of the allowance for uncollectible accounts _____

CASE STUDY (20%)

Choose one out of two:

Case 1 - Adam Co. is a pharmaceutical manufacturer. The purchasing department is managed by Mr. Saab and his assistant Jad Abyad. The value of annual purchases is about \$3 million. When goods are required, the inventory records clerk, Fareed, sends a purchase requisition to Mr. Saab, who asks Jad to type out a purchase order. Jad manually enters a sequential number onto the purchase order and photocopies the order. The original is sent to the supplier and the copy is kept in a file.

When the goods arrive, they are stored in the warehouse and the supplier's dispatch note is sent to Jad by the warehouse supervisor. Jad then marks off the items received on the order and sends the dispatch note to Fareed, who uses it to update the inventory records before filing it in chronological sequence.

Required:

- a. Identify five deficiencies in the system and state their implications.
 - b. suggest recommendations to improve the system, assuming that Adam Co has sufficient resources to implement suitable recommendations.
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Case 2- A junior auditor in a CPA firm, completed an audit of the 2013 financial statements of XYZ Corporation on March 17, 2014, and concluded that an unqualified opinion was justified for 2013. Because of a scope limitation arising from the inability to observe the January 1, 2012 inventory, the firm had previously issued a report which contained an unqualified opinion on the December 31, 2012 balance sheet and a disclaimer of opinion with respect to the statements of income, retained earnings, and cash flow for the year then ended. In updating that report, the firm believes that it is still appropriate.

The management of XYZ Corporation has decided to present a complete set of comparative (2013 and 2012) financial statements in their annual report.

The audit manager reviewed the draft report prepared by the junior auditor, and indicated that there were several deficiencies in the draft report.

Independent Auditor's Report

TO: Management of XYZ Corporation

We have audited the accompanying balance sheets of XYZ Corporation as of December 31, 2013 and 2012 and the related financial statements for the years then ended. All information included in these financial statements is the representation of the management of XYZ Corporation. Our responsibility is to express an opinion on these financial statements based on our audits.

Except as explained in the following paragraph, we conducted our audits in accordance with International Standards on Auditing. Those standards require that we plan and perform our audit to obtain reasonable assurance about whether the financial statements are free of misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

We did not observe the taking of the physical inventory as of January 1, 2012, since that date was prior to our appointment as auditors for XYZ Corporation, and we were unable to satisfy ourselves regarding inventory quantities by means of other auditing procedures. Inventory amounts as of January 1, 2012, enter into the determination of net income and cash flows for the year ended December 31, 2012.

Because of the matter discussed in the preceding paragraph, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the results of

operations and cash flows for the year ended December 31, 2012, and our overall report should therefore be considered as so qualified.

In our opinion, the balance sheets of XYZ Corporation as of December 31, 2013, and 2012, and the related statements of income, retained earnings, and cash flows for the year ended December 31, 2013 present fairly the financial position of XYZ Corporation as of December 31, 2013 and 2012 and the results of its operations and its cash flows for the year ended December 31, 2013, are in conformity with International Standards on Auditing.

XYZ & Co. CPAs

March 17, 2014

Required:

- a) Items 1 through 10 represent deficiencies noted by the audit manager. For each deficiency, indicate whether the audit manager is correct or incorrect in the criticism of the junior auditor' draft report.
1. The report should not be addressed to the management but instead to the board of directors and/or stockholders.
 2. The accountant's responsibilities should precede the responsibilities of management in the introductory paragraph
 3. Each financial statement audited should be specifically identified in the introductory paragraph of the auditor's report.
 4. The wording for the responsibilities of management is that for a review report, not an audit report.
 5. There should be a statement in the second paragraph that the auditor has a responsibility to search for misstatements and fraud in the financial statements.
 6. There should be a statement in the second paragraph that the financial statements are free of material misstatement
 7. There should be an indication that an audit also includes assessing the significant estimates made by management.
 8. The term "overall report should be considered as qualified" should be deleted.
 9. There should be a reference to "conformity with International Financial Reporting Standards" in the fifth paragraph.
 10. The report should be signed and dated December 31, 2013.
- b) What other deficiencies exist in the format and content in this report? Prepare a short listing of what has been noted by you.