

MULTIPLE CHOICE QUESTIONS (40%)

1. One objective of an operational audit is to:
 - A) determine whether the financial statements fairly present the entity's operations.
 - B) determine if the auditee is in compliance with IFRS.
 - C) make recommendations for improving performance.
 - D) report on the entity's relative success in attaining profit maximization.

2. An audit to determine whether an entity is following specific procedures or rules set down by some higher authority is classified as a(n):
 - A) audit of financial statements.
 - B) compliance audit.
 - C) operational audit.
 - D) production audit.

3. 4) An auditor need not abide by a particular auditing standard if the auditor believes that:
 - A) the issue in question is immaterial in amount.
 - B) more expertise is needed to fulfill the requirement.
 - C) the requirement of the standard has not been addressed by the Ministry of Finance.
 - D) any of the above three are correct.

4. If the balance sheet of a private company is dated December 31, 2011, the audit report is dated February 8, 2012, and both are released on February 15, 2012, this indicates that the auditor has searched for subsequent events that occurred up to:
 - A) December 31, 2011.
 - B) January 1, 2012.
 - C) February 8, 2012.
 - D) February 15, 2012.

5. When there is uncertainty about a company's ability to continue as a going concern, the auditor's concern is the possibility that the client may not be able to continue its operations or meet its obligations for a "reasonable period of time." For this purpose, a reasonable period of time is considered not to exceed:
 - A) six months from the date of the financial statements.
 - B) one year from the date of the financial statements.
 - C) six months from the date of the audit report.
 - D) one year from the date of the audit report.

6. Which of the following requires recognition in the auditor's opinion as to consistency?
 - A) The correction of an error in the prior year's financial statements resulting from a mathematical mistake in capitalizing interest.
 - B) A change in the estimate of provisions for warranty costs.
 - C) The change from the cost method to the equity method of accounting for investments in common stock.

- D) A change in depreciation method which has no effect on current year's financial statements but is certain to affect future years.
7. As a result of management's refusal to permit the auditor to physically examine inventory, the auditor must depart from the unqualified audit report because:
- A) the financial statements have not been prepared in accordance with IFRS.
 - B) the scope of the audit has been restricted by circumstances beyond either the client's or auditor's control.
 - C) the financial statements have not been audited in accordance with GAAS.
 - D) the scope of the audit has been restricted.
8. In which situation would the auditor be choosing between "except for" qualified opinion and an adverse opinion?
- A) The auditor lacks independence.
 - B) A client-imposed scope limitation
 - C) A circumstance imposed scope limitation
 - D) Lack of full disclosure within the footnotes
9. The dollar amount of some misstatements cannot be accurately measured. For example, if the client were unwilling to disclose an existing lawsuit, the auditor must estimate the likely effect on:
- A) net income.
 - B) users of the financial statements.
 - C) the auditor's exposure to lawsuits.
 - D) management's future decisions.
10. When dealing with materiality and scope limitation conditions:
- A) a disclaimer of opinion must be issued.
 - B) it is easier to evaluate the materiality of potential misstatements resulting from a scope limitation than for failure to follow IFRS.
 - C) scope limitations imposed by the client are always considered material.
 - D) a unqualified opinion may still be issued depending on the materiality of the scope limitation.
11. After the auditor determines whether any conditions exist which require a departure from a standard unqualified report, the next step in the decision process for audit reports is to:
- A) write the report.
 - B) decide the materiality for each condition.
 - C) decide the appropriate type of report for the condition.
 - D) discuss the report with management.

12. The members of a client's "audit committee" should be:
- A) members of management.
 - B) directors who are not a part of company management.
 - C) non-directors and non-managers.
 - D) directors and managers.
13. Management makes the following assertions about account balances:
- A) existence, completeness, classification and cutoff.
 - B) existence, accuracy, classification and rights and obligations.
 - C) existence, completeness, valuation and allocation, and rights and obligations.
 - D) existence, completeness, rights and obligations, and cutoff.
14. The auditor is determining that the correct selling price was used for billing and that the quantity of goods shipped was the same as the quantity billed. She is gathering evidence about which transaction related audit objective?
- A) Existence
 - B) Completeness
 - C) Accuracy
 - D) Cut-off
15. 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
16. A measure of how willing the auditor is to accept that the financial statements may be materially misstated after the audit is completed and an unqualified opinion has been issued is the:
- A) inherent risk.
 - B) acceptable audit risk.
 - C) statistical risk.
 - D) financial risk.
17. The auditor uses knowledge gained from the understanding of the client's business and industry to assess:
- A) client business risk.
 - B) control risk.
 - C) inherent risk.
 - D) audit risk.

18. A related party transaction may be indicated when another company:
 - A) subsidizes certain operating expenses of the company.
 - B) purchases its securities at their fair value.
 - C) loans to company at market rates.
 - D) has had a distributor relationship with the company for 10 years.

19. An auditor should examine minutes of the board of directors' meetings:
 - A) through the date of the financial statements.
 - B) through the date of the audit report.
 - C) only at the beginning of the audit.
 - D) on a test basis.

20. During audit planning, the auditor uses analytical procedures primarily to:
 - A) identify weaknesses in internal control.
 - B) determine if the company's financial statements appear reasonable and are free of material misstatement.
 - C) determine the correspondence of the company's financial statements to the valuation and accuracy audit objectives.
 - D) determine the nature, extent, and timing of audit procedures.

21. Which of the following is the primary basis used to decide materiality for a for-profit entity?
 - A) Net sales
 - B) Net assets
 - C) Net income before tax
 - D) All of the above

22. The risk that audit evidence for a segment will fail to detect misstatements exceeding performance materiality levels is:
 - A) audit risk.
 - B) control risk.
 - C) inherent risk.
 - D) planned detection risk.

23. To what extent do auditors typically rely on internal controls of their public company clients?
 - A) Extensively
 - B) Only very little
 - C) Infrequently
 - D) Never

24. Internal controls are not designed to provide reasonable assurance that:
 - A) all frauds will be detected.
 - B) transactions are executed in accordance with management's authorization.
 - C) the company's resources are used efficiently and effectively.

- D) company personnel comply with applicable rules and regulations.
25. Proper segregation of functional responsibilities calls for separation of:
- A) authorization, execution, and payment.
 - B) authorization, recording, and custody.
 - C) custody, execution, and reporting.
 - D) authorization, payment, and recording.
26. Which of the following groups establishes and maintains the company's internal controls?
- A) Internal auditors
 - B) Board of Directors
 - C) Management
 - D) Audit committee
27. Audit evidence regarding the separation of duties is normally best obtained by:
- A) preparing flowcharts of operational processes.
 - B) preparing narratives of operational processes.
 - C) observation of employees applying control activities.
 - D) inquiries of employees applying control activities.
28. Financial statement manipulation risk is arguably present for all companies' financial statements. However, the risk is elevated for companies that:
- A) are heavily regulated.
 - B) have low amounts of debt.
 - C) have to make significant judgments for accounting estimates.
 - D) operate in stable economic environments.
29. The document that details the specific audit procedures for each type of test is the:
- A) audit strategy.
 - B) audit program.
 - C) audit procedure.
 - D) audit risk model.
30. Which audit tests involve physical examination and confirmation?
- A) Tests of controls
 - B) Tests of transactions
 - C) Tests of balances
 - D) Analytic al procedures
31. For a firm that practices good internal controls in the sales and collections cycle, the function of indicating credit approval should be recorded on which of the following documents?
- A) Sales order

- B) Sales invoice
- C) Customer order
- D) Remittance advice

32. The auditor traces items from the source documents to the journals in order to accumulate audit evidence that will satisfy the:
- A) existence objective.
 - B) completeness objective.
 - C) ownership objective.
 - D) valuation objective.
33. An auditor is performing a credit analysis of customers with balances over 60 days due. She is most likely obtaining evidence for which audit related objective?
- A) Realizable value
 - B) Existence
 - C) Completeness
 - D) Occurrence
34. An accounts receivable population contains a total of four customers. The accounts, the amounts, and the cumulative total are shown below. Monetary unit sampling is to be used.

| Account Name | Recorded Amount | Cumulative Total |
|--------------|-----------------|------------------|
| Blue | \$ 357 | \$ 357 |
| Brown | 281 | 638 |
| Gray | 60 | 698 |
| Green | 574 | 1,272 |

Based on the information above, the population size is:

- A) 4.
 - B) 574.
 - C) 1,272.
 - D) \$2,684.
35. When an auditor recomputes the unexpired portion of prepaid insurance, they are satisfying which audit objective?
- A) Completeness
 - B) Existence
 - C) Accuracy and detail tie-in
 - D) Rights

36. The estimated unpaid obligations for services or benefits that have been received before the balance sheet date are:
- A) accounts payable.
 - B) accounts receivable.
 - C) unearned liabilities.
 - D) accrued liabilities.
37. The auditor needs to be aware that most users of financial statements rely most heavily on the _____ for making decisions.
- A) balance sheet
 - B) income statement
 - C) statement of cash flows
 - D) statement of stockholders' equity
38. Place the following steps in their proper order:
- 1. Analyze expectations
 - 2. Select the sample
 - 3. Define attributes and exceptions conditions
 - 4. State the objectives of the audit test
 - 5. Specify the tolerable exception rate
- a- 1, 2, 3, 4, 5
 - b- 4, 3, 1, 2, 5
 - c- 4, 3, 5, 2, 1
 - d- 1, 3, 2, 4, 5
39. If a potential loss on a contingent liability is remote, the liability usually is
- a- Disclosed in footnotes, but not accrued.
 - b- Neither accrued nor disclosed in footnotes.
 - c- Accrued and indicated in the body of the financial statements.
 - d- Disclosed in the auditor's report, but not disclosed on the financial statements
40. Which of the following is not an application control?
- a- Preprocessing authorization of sales transactions.
 - b- Reasonableness test for unit selling of sales transactions.
 - c- Post-processing review of sales transactions by the sales department.
 - d- Separation of duties between computer programmer and operators.

TRUE & FALSE (13%)

1. Changes in accounting estimates requires the auditor to issue a modified unqualified audit report with a consistency paragraph inserted after the opinion paragraph.
 - A) True
 - B) False

2. A qualified report can take the form of a qualification of both the scope and the opinion or of the opinion alone.
 - A) True
 - B) False

3. Confirmations are ordinarily used to verify account balances, but may be used to verify transactions.
 - A) True
 - B) False

4. One purpose of performing preliminary analytical procedures in the planning phase of an audit is to help the auditor make a preliminary assessment of control risk.
 - A) True
 - B) False

5. The quick ratio has the same denominator as the current ratio.
 - A) True
 - B) False

6. The lower the dollar amount of the preliminary judgment the more audit evidence is required.
 - A) True
 - B) False

7. In applying the audit risk model, auditors are concerned about overstatements, not understatements.
 - A) True
 - B) False

8. Adequate documents and records is a subcomponent of the control environment.
- A) True
 - B) False
9. Auditing standards prohibit reliance on the work of internal auditors due to the lack of independence of the internal auditors.
- A) True
 - B) False
10. For most uses, flowcharts are superior to narratives as a method of communicating the characteristics of internal control.
- A) True
 - B) False
11. The assessment of control risk is the measure of the auditor's expectation that internal controls will prevent material misstatements from occurring or detect and correct them if they have occurred.
- A) True
 - B) False
12. The scope of the auditor's report on internal control is limited to obtaining reasonable assurance that significant weaknesses in internal control are identified.
- A) True
 - B) False
13. To issue an unqualified opinion on internal control over financial reporting, there must be no identified material weaknesses and no restrictions on the scope of the audit.
- A) True
 - B) False

14. Control risk is generally set at minimum for most private companies.
- A) True
 - B) False
15. The two main categories of fraud are fraudulent financial reporting and misappropriation of assets.
- A) True
 - B) False
16. Misappropriation of assets is normally perpetrated at the lowest levels of the organization hierarchy.
- A) True
 - B) False
17. Credit should be approved before goods are shipped to a customer.
- A) True
 - B) False
18. Depreciation expense is normally verified as a part of tests of details of balances rather than as part of tests of controls or substantive tests of transactions.
- A) True
 - B) False
19. Confirmations are commonly used to verify additions of property, plant, and equipment.
- A) True
 - B) False
20. When auditing insurance expense, auditors normally rely on analytical procedures and limited testing of the debits to ensure that they arose from credits to prepaid insurance.
- A) True
 - B) False
21. When auditing acquisitions of property, plant and equipment, the auditor's review of lease and rental agreements most closely relates to the cutoff

objective.

- A) True
- B) False

22. Planning the audit facilitates obtaining appropriate audit evidence and managing audit costs, but it does not reduce misunderstandings with the client.

- A) True
- B) False

23. In auditing cash, the auditor is more interested in changes during the year than the ending balance.

- A) True
- B) False

24. Generalized audit software is used to test automated controls

- A) True
- B) False

25. It is generally more difficult for the auditor to detect payment of fraudulent hours than payment of fictitious employees.

- A) True
- B) False

26. Regression analysis measures the rate by which an independent variable changes in relation to dependent variable

- A) True
- B) False

Cases

Case 1 (16%)

Match the engagement described to the:

- (A) Type of audit, and
- (B) Auditor that would perform the engagement.

Each engagement will have an answer from List-A and List-B. An answer can be used once, more than once, or not at all.

| List A - Type of Audit: | List B - Type of Auditor: |
|---|---|
| <ul style="list-style-type: none"> a. Financial Statement b. Compliance c. Operational | <ul style="list-style-type: none"> d. Internal e. External f. Government g. Internal Revenue Services - IRS |

Engagement:

1. Evaluate a company's payroll processing for the company.
2. Evaluate if bank agreements are being met.
3. Evaluate financial statements that are to be submitted to a bank.
4. Evaluate the promptness of materials inspection in a manufacturer's receiving department.
5. Determine if Medicare reimbursements are in accordance with the Healthcare Financing Administration (HCFA).
6. Determine if the tax return of a multinational corporation is in accordance with the tax code.
7. Determine if a non-profit organization is applying correctly the basis of valuation on the donations-in-kind received.
8. Determine the effectiveness of a Department of Defense project presented.

Case 2 (12%)

Listed below are several accounts listed from a company's trial balance. Next to each account put the letter corresponding to the transaction cycle used to audit the account:

- S = Sales and collection cycle
- I = Inventory and warehousing cycle
- A = Acquisition and payment cycle
- C = Capital acquisition and repayment cycle
- P = Payroll and personnel cycle

1. _____ Sales returns and allowances
2. _____ Capital stock
3. _____ Buildings
4. _____ Notes payable

- 5. _____ Salaries and commissions
- 6. _____ Cost of goods sold
- 7. _____ Trade accounts receivable
- 8. _____ Rent

Case 3 (7%)

Match seven of the terms (a-k) with the definitions provided below (1-7):

- a. Tests of details of balances
- b. Tests of controls
- c. Substantive tests of transactions
- d. Analytical procedures
- e. Transaction-related audit objectives
- f. Management assertions
- g. Balance-related audit objectives
- h. Fraud
- i. Illegal act
- j. Error
- k. Management fraud

_____ 1. An intentional misstatement of the financial statements.

_____ 2. A set of six audit objectives the auditor must meet, including timing, posting and summarization, and accuracy.

_____ 3. Implied or expressed representations made by the client about classes of transactions, account balances and disclosures in the financial statements.

_____ 4. Audit procedures testing for monetary misstatements to determine whether the balance-related audit objectives have been satisfied for each significant account balance.

_____ 5. A set of nine audit objectives the auditor must meet, including completeness, detail tie-in, and rights and obligations.

_____ 6. Audit procedures designed to test the effectiveness of control policies and procedures.

_____ 7. Use of comparisons and relationships to assess whether account balances or other data appears reasonable.

Case 4 (12%)

Below are 12 audit procedures. Classify each procedure according to the following types of audit evidence:

- (1) physical examination,
- (2) confirmation,
- (3) documentation,
- (4) observation,
- (5) inquiry of the client,
- (6) reperformance, and
- (7) analytical procedure.

| Type of Evidence | Audit Procedures |
|------------------|---|
| | 1. Watch client employees count inventory to determine whether company procedures are being followed. |
| | 2. Count inventory items and record the amount in the audit files. |
| | 3. Trace postings from the sales journal to the general ledger accounts. |
| | 4. Calculate the ratio of cost of goods sold to sales as a test of overall reasonableness of gross margin relative to the preceding year. |
| | 5. Obtain information about the client's internal controls by asking questions of client personnel. |
| | 6. Trace column totals from the cash disbursements journal to the general ledger. |
| | 7. Examine a piece of equipment to make sure a recent purchase of equipment was actually received and is in operation. |
| | 8. Review the total of repairs and maintenance for each month to determine whether any month's total was unusually large. |
| | 9. Compare vendor names and amounts on purchase invoices with entries in the purchases journal. |
| | 10. Foot entries in the sales journal to determine whether they were correctly totaled by the client. |
| | 11. Make a surprise count of petty cash to verify that the amount of the petty cash fund is intact. |
| | 12. Obtain a written statement from the client's bank stating the client's year-end balance on deposit. |

