

I - MULTIPLE CHOICE QUESTIONS (45%)

1- A CPA firm's personnel partner periodically studies the CPA firm's personnel advancement experience to ascertain whether individuals increased degrees of responsibility. This is evidence of the CPA firm's adherence to prescribed standards of

- A: Quality control.
- B: Due professional care.
- C: Supervision and review.
- D: Fieldwork.

2 – Auditing standards require that the examination of financial statements is to be performed by a person or persons having adequate technical training and

- A: Independence with respect to the financial statements and supplementary disclosures.
- B: Exercising professional care as judged by peer reviewers.
- C: Proficiency as an auditor which likely has been acquired from previous experience.
- D: Objectivity as an auditor as verified by proper supervision

3 - Rogers & Co., CPAs, policies require that all members of the audit staff submit weekly time reports to the audit manager, who then prepares a weekly summary work report regarding variance from budget for Rogers' review. This provides written evidence of Rogers & Co.'s professional concern regarding compliance with which of the following IAS?

- A: Quality control.
- B: Due professional care.
- C: Adequate review.
- D: Adequate planning

4 - Auditing standards state that due care is to be exercised in the performance of the examination. This standard means that a CPA who undertakes an engagement assumes a duty to perform each audit

- A: As a professional possessing the degree of skill commonly possessed by others in the field.
- B: In conformity with generally accepted accounting principles.
- C: With reasonable diligence and without fault or error.
- D: To the satisfaction of governmental agencies and investors who rely upon the audit.

5- 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.

6- As a lower acceptable level of materiality is established, the auditor should plan more work on individual accounts to

- A: Find smaller misstatements.
- B: Find larger misstatements.
- C: Increase the tolerable misstatement in the accounts.
- D: Decrease the risk of assessing control risk too low.

7- Which of the following is included as part of the definition of audit sampling?

- A: Inquiry and observation procedures.
- B: Documentary evidence.
- C: Evaluation of some characteristic.
- D: Statistical techniques.

8 - The auditor faces a risk that the examination will not detect material misstatements which occur in the accounting process. In regard to minimizing this risk, the auditor primarily relies on

- A: Substantive tests.
- B: Tests of controls.
- C: Internal control.
- D: Statistical analysis.

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

	<u>Number of accounts</u>	<u>Book balance</u>	<u>Audited balance</u>
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

10 - An auditor should obtain evidential matter relevant to all the following factors concerning third-party litigation against a client except the

- A: Period in which the underlying cause for legal action occurred.
- B: Probability of an unfavorable outcome.
- C: Jurisdiction in which the matter will be resolved.
- D: Existence of a situation indicating an uncertainty as to the possible loss.

11 - Auditors should request that an audit client send a letter of inquiry to those attorneys who have been consulted concerning litigation, claims, or assessments. The primary reason for this request is to provide

- A: Information concerning the progress of cases to date.
- B: Corroborative evidential matter.
- C: An estimate of the dollar amount of the probable loss.
- D: An expert opinion as to whether a loss is possible, probable, or remote.

12 - An auditor searching for related-party transactions should obtain an understanding of each subsidiary's relationship to the total entity because

- A: This may permit the audit of intercompany account balances to be performed as of concurrent dates.
- B: Intercompany transactions may have been consummated on terms equivalent to arm's-length transactions.

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C: This may reveal whether particular transactions would have taken place if the parties had not been related.

D: The business structure may be deliberately designed to obscure related-party transactions.

13 - After discovering that a related-party transaction exists, the auditor should be aware that the

A: Substance of the transaction could be significantly different from its form.

B: Adequacy of disclosure of the transaction is secondary to its legal form.

C: Transaction is assumed to be outside the ordinary course of business.

D: Financial statements should recognize the legal form of the transaction rather than its substance.

14 - An independent auditor finds that a corporation occupies office space, at no charge, in an office building owned by a shareholder. This finding indicates the existence of

A: Management fraud.

B: Related-party transactions.

C: Window dressing.

D: Weak internal control

15 - Which of the following audit procedures would most likely assist an auditor in identifying conditions and events that may indicate there could be substantial doubt about an entity's ability to continue as a going concern?

A: Review compliance with the terms of debt agreements.

B: Confirmation of accounts receivable from principal customers.

C: Reconciliation of interest expense with debt outstanding.

D: Confirmation of bank balances.

16 - A client acquired 25% of its outstanding capital stock after year-end and prior to completion of the auditor's fieldwork. The auditor should

A: Advise management to adjust the balance sheet to reflect the acquisition.

B: Issue pro forma financial statements giving effect to the acquisition as if it had occurred at year-end.

C: Advise management to disclose the acquisition in the notes to the financial statements.

D: Disclose the acquisition in the opinion paragraph of the auditor's report.

17 - An auditor concludes that a substantive auditing procedure considered necessary during the prior period's audit was omitted. Which of the following factors would most likely cause the auditor promptly to apply the omitted procedure?

A: There are no alternative procedures available to provide the same evidence as the omitted procedure.

B: The omission of the procedure impairs the auditor's present ability to support the previously expressed opinion.

C: The source documents needed to perform the omitted procedure are still available.

D: The auditor's opinion on the prior period's financial statements was unqualified.

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18 - The primary objective of analytical procedures used in the final review stage of an audit is to

- A:** Obtain evidence from details tested to corroborate particular assertions.
 - B:** Identify areas that represent specific risks relevant to the audit.
 - C:** Assist the auditor in assessing the validity of the conclusions reached.
 - D:** Satisfy doubts when questions arise about a client's ability to continue in existence.
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19 - Before performing a review of a nonpublic entity's financial statements, an accountant should

- A:** Complete a series of inquiries concerning the entity's procedures for recording, classifying, and summarizing transactions.
 - B:** Apply analytical procedures to provide limited assurance that no material modifications should be made to the financial statements.
 - C:** Obtain a sufficient level of knowledge of the accounting principles and practices of the industry in which the entity operates.
 - D:** Inquire whether management has omitted substantially all of the IAS.
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20 - When making a review of interim financial information the auditor's work consists primarily of

- A:** Studying and evaluating limited amounts of documentation supporting the interim financial information.
 - B:** Scanning and reviewing client-prepared, internal financial statements.
 - C:** Making inquiries and performing analytical procedures concerning significant accounting matters.
 - D:** Confirming and verifying significant account balances at the interim date.
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21 - Which of the following procedures is usually performed by the accountant in a review engagement of a nonpublic entity?

- A:** Sending a letter of inquiry to the entity's lawyer.
 - B:** Comparing the financial statements with statements for comparable prior periods.
 - C:** Confirming a significant percentage of receivables by direct communication with debtors.
 - D:** Communicating reportable conditions discovered during the study of the internal control
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22 - A typical objective of an operational audit is for the auditor to

- A:** Determine whether the financial statements fairly present the entity's operations.
 - B:** Evaluate the feasibility of attaining the entity's operational objectives.
 - C:** Make recommendations for improving performance.
 - D:** Report on the entity's relative success in attaining profit maximization.
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23 - 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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24- 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

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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
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25 - 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.
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26 - 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 the International Financial Reporting Standards.
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27 - Effective internal control over the payroll function would include which of the following?

- A:** Total time recorded on time-clock punch cards should be reconciled to job reports by employees responsible for those specific jobs.
 - B:** Payroll department employees should be supervised by the management of the personnel department.
 - C:** Payroll department employees should be responsible for maintaining employee personnel records.
 - D:** Total time spent on jobs should be compared with total time indicated on time-clock punch cards.
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28 - Which of the following questions would an auditor most likely include on an internal control questionnaire for notes payable?

- A:** Are assets that collateralize notes payable critically needed for the entity's continued existence?
 - B:** Are two or more authorized signatures required on checks that repay notes payable?
 - C:** Are the proceeds from notes payable used for the purchase of noncurrent assets?
 - D:** Are direct borrowings on notes payable authorized by the board of directors?
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29 - In order to avoid the misappropriation of company-owned marketable securities, which of the following is the best course of action that can be taken by the management of a company with a large portfolio of marketable securities?

- A:** Require that one trustworthy and bonded employee be responsible for access to the safekeeping area, where securities are kept.

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B: Require that employees who enter and leave the safekeeping area sign and record in a log the exact reason for their access.

C: Require that employees involved in the safekeeping function maintain a subsidiary control ledger for securities on a current basis.

D: Require that the safekeeping function for securities be assigned to a bank that will act as a custodial agent.

30 - When there are numerous property and equipment transactions during the year, an auditor planning to assess control risk at the minimum level usually plans to obtain an understanding of the internal control and to perform

A: Tests of controls and extensive tests of property and equipment balances at the end of the year.

B: Extensive tests of current year property and equipment transactions.

C: Tests of controls and limited tests of current year property and equipment transactions.

D: Analytical procedures for property and equipment balances at the end of the year.

31 - A weakness in internal control over recording retirements of equipment may cause the auditor to

A: Inspect certain items of equipment in the plant and trace those items to the accounting records.

B: Review the subsidiary ledger to ascertain whether depreciation was taken on each item of equipment during the year.

C: Trace additions to the "other assets" account to search for equipment that is still on hand but no longer being used.

D: Select certain items of equipment from the accounting records and locate them in the plant.

32 - Which of the following is the most important internal control activity over acquisitions of property, plant, and equipment?

A: Establishing a written company policy distinguishing between capital and revenue expenditures.

B: Using a budget to forecast and control acquisitions and retirements.

C: Analyzing monthly variances between authorized expenditures and actual costs.

D: Requiring acquisitions to be made by user departments.

33 - Equipment acquisitions that are misclassified as maintenance expense most likely would be detected by a control that provides for

A: Segregation of duties of employees in the accounts payable department.

B: Independent verification of invoices for disbursements reported as equipment acquisitions.

C: Investigation of variances within a formal budgeting system.

D: Authorization by the board of directors of significant equipment acquisitions.

34 - During the audit the independent auditor identified the existence of a reportable condition in the client's internal control and orally communicated this finding to the client's senior management and audit committee. The auditor should

A: Consider the reportable condition a scope limitation and therefore disclaim an opinion.

B: Document the matter in the working papers and consider the effects of the condition on the audit.

- C: Suspend all audit activities pending directions from the client's audit committee.
 D: Withdraw from the engagement.

35 - Should an auditor communicate the following matters to an audit committee of a public entity?

	<i>Significant audit adjustments recorded by the entity</i>	<i>Management's consultation with other accountants adjustments recorded about significant <u>accounting matters</u></i>
I	Yes	Yes
II	Yes	No
III	No	Yes
IV	No	No

- A: I
 B: II.
 C: III.
 D: IV.

36 - When an auditor issues an unqualified opinion on an entity's internal control, it is implied that the

- A: Entity has not violated provisions of the Foreign Corrupt Practices Act.
 B: Likelihood of management fraud is minimal.
 C: Financial records are sufficiently reliable to permit the preparation of financial statements.
 D: Entity's system of internal control is in conformity with criteria established by its audit committee.

37 - For which of the following judgments may an independent auditor share responsibility with an entity's internal auditor who is assessed to be both competent and objective?

	<i>Materiality of <u>misstatements</u></i>	<i>Evaluation of <u>accounting estimates</u></i>
I	Yes	No
II	No	Yes
III	No	No
IV	Yes	Yes

- A: I.
 B: II
 C: III.
 D:IV

38 - If the independent auditor decides that the work performed by internal auditors may have a bearing on the independent auditor's own procedures, the independent auditor should consider the objectivity of the internal auditors. One method of judging objectivity is to

- A: Review the recommendations made in the reports of internal auditors.
 B: Examine, on a test basis, documentary evidence of the work performed by internal auditors.
 C: Inquire of management about the qualifications of the internal audit staff.
 D: Consider the client's practices for hiring, training, and supervising the internal audit staff.

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39- Management's attitude toward aggressive financial reporting and its emphasis on meeting projected profit goals most likely would significantly influence an entity's control environment when

- A:** The audit committee is active in overseeing the entity's financial reporting policies.
 - B:** External policies established by parties outside the entity affect its accounting practices.
 - C:** Management is dominated by one individual who is also a shareholder.
 - D:** Internal auditors have direct access to the board of directors and entity management.
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40 - Which of the following professional services would be considered an attest engagement?

- A:** A management consulting engagement to provide accounting information systems advice to a client.
 - B:** An engagement to report on compliance with statutory requirements.
 - C:** An income tax engagement to prepare federal and state tax returns.
 - D:** The compilation of financial statements from a client's accounting records.
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41 -It would not be appropriate for the auditor to initiate discussion with the audit committee concerning

- A:** The extent to which the work of internal auditors will influence the scope of the examination.
 - B:** Details of the procedures which the auditor intends to apply.
 - C:** The extent to which change in the company's organization will influence the scope of the examination.
 - D:** Details of potential problems which the auditor believes might cause a qualified opinion.
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42- Skates, an independent auditor, was engaged to perform an examination of the financial statements of Apex Incorporated 1 month after its fiscal year had ended. Although the inventory count was not observed by Skates, and accounts receivable were not confirmed by direct communication with creditors, Skates was able to gain satisfaction by applying alternative auditing procedures. Skates' auditor's report will probably contain

- A:** An "except for" qualification.
 - B:** An unqualified opinion and an explanatory paragraph.
 - C:** Either a qualified opinion or a disclaimer of opinion.
 - D:** A standard unqualified opinion.
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43 - "Subsequent events" for reporting purposes are defined as events which occur subsequent to the

- A:** Balance sheet date.
 - B:** Date of the auditor's report.
 - C:** Balance sheet date but prior to the date of the auditor's report.
 - D:** Date of the auditor's report and concern contingencies which are not reflected in the financial statements.
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44 - 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.

45 - When the financial statements of a nonpublic entity for a prior period have not been audited and are presented, for comparative purposes, with current period statements that have been audited,

A: The auditor should request removal of the unaudited statements since it is improper to present them for comparative purposes with audited statements.

B: The auditor should identify the financial statements that were not examined in a separate paragraph in the auditor's report accompanying the current statements.

C: The unaudited statements do not need to be marked "unaudited" as this may confuse the users of the statements.

D: The auditor's report accompanying the statements should not mention that the prior period statements are unaudited, but the unaudited statements should be marked "unaudited."

II - TRUE OR FALSE (15%)

1 - Review reports are normally dated as of the client's balance sheet date.

2 - Of the three types of attestation engagements, examination engagements provide a higher level of assurance than agreed-upon procedures engagements but less than review engagements.

3 - Audit risk is the risk there will be an audit failure for a given audit engagement.

4 - Gross negligence is the existence of extreme or unusual negligence with the intent to deceive.

5 - Many litigation experts believe that a well written engagement letter significantly reduces the likelihood of adverse legal actions.

6 - Other than inquiring of management about policies they have established to prevent illegal acts and whether management knows of any laws or regulations that the company has violated, the auditor should not search for illegal acts that do not have a direct effect on the financial statements unless there is reason to believe they may exist.

7 - When an auditor believes that an illegal act may have occurred, the first step he or she should take is to gather additional evidence to determine the extent of the illegality and if there is a direct impact on the financial statements.

8 - The transaction-related audit objective of timing is related to the assertion of cutoff.

9 - Tests of details of balances typically involve the use of comparisons and relationships to assess the overall reasonableness of account balances.

10 - When examining the relationships of the five cycles and general cash, the cycles have no beginning or end except at the origin or final disposition of the company.

11 - When analytical procedures reveal unusual fluctuations in an account balance, the auditor will probably perform fewer tests of details for that account and increase the tests of controls related to the account.

12- An engagement letter can affect the CPA firm's legal responsibilities to the client, but does not affect responsibility to external users of audited financial statements.

13 - If an auditor wishes to rely on the work of internal auditors (IA), the auditor must obtain satisfactory evidence related to the IA's competence, integrity, and objectivity.

14 - Walkthroughs combine observation, inspection, and inquiry to assure that the controls designed by management have been implemented.

15- In a standard inquiry of client's attorney letter, the attorney is requested to communicate about contingencies up to the balance sheet date.

III - CASES (40%)

CASE 1 of 2

The fieldwork for the December 31, 2007 audit of Tribble Corporation ended on March 17, 2008. The financial statements and auditor's report were issued and mailed to stockholders on March 29, 2008. In each of the material situations (1 through 5) below, indicate the appropriate action (a, b, c, d, or e). The possible actions are as follows:

- a. Adjust the December 31, 2007 financial statements.
- b. Disclose the information in a footnote in the December 31, 2007 financial statements.
- c. Request the client revise and reissue the December 31, 2007 financial statements. The revision should involve an adjustment to the December 31, 2007 financial statements.
- d. Request the client revise and reissue the December 31, 2007 financial statements. The revision should involve the addition of a footnote, but no adjustment, to the December 31, 2007 financial statements.
- e. No action is required.

Answers

The situations are as follows:

- _____ 1. On January 16, 2008, a lawsuit was filed against Tribble for a patent infringement action that allegedly took place in early 2005. In the opinion of Tribble's attorneys, there is a reasonable (but not probable) danger of a significant loss to Tribble.
- _____ 2. On February 19, 2008, Tribble settled a lawsuit out of court that had originated in 2002 and is currently listed as a contingent

- liability.
- _____ 3. On March 30, 2008, Tribble settled a lawsuit out of court that had originated in 2004 and is currently listed as a contingent liability.
- _____ 4. On February 2, 2008, you discovered an uninsured lawsuit against Tribble that had originated on August 30, 2007.
- _____ 5. On April 7, 2008, you discovered that a debtor of Tribble went bankrupt on January 22, 2008, due to a major uninsured fire that occurred on January 2, 2008.

CASE 2 of 2

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

- a. Accounts receivable balance-related audit objectives
- b. Aged trial balance
- c. Alternative procedures
- d. Blank confirmation form
- e. Cutoff misstatements
- f. Evidence planning worksheet
- g. Negative confirmation
- h. Positive confirmation
- i. Realizable value of accounts receivable
- j. Timing difference in an account receivable confirmation
- k. Invoice confirmation

Answers

- _____ 1. The follow-up of a positive confirmation not returned by the debtor with the use of documentation evidence to determine whether the recorded receivable exists and is collectible.
- _____ 2. A letter, addressed to the debtor, requesting that the recipient indicate directly on the letter whether the stated account balance is correct or incorrect and, if incorrect, by what amount.
- _____ 3. Misstatements that take place as a result of current period transactions being recorded in a subsequent period, or subsequent period transactions being recorded in the current period.
- _____ 4. A form used to help the auditor decide whether planned detection risk for tests of details of balances should be low, medium, or high for each balance-related audit objective.
- _____ 5. A letter, addressed to the debtor, requesting a response only if the recipient disagrees with the amount of the stated account balance.
- _____ 6. A reported difference in a confirmation from a debtor that is determined to be a timing difference between the client's and debtor's records and therefore not a misstatement.
- _____ 7. A listing of the balances in the accounts receivable master file at the balance sheet date broken down according to the amount of time that has passed between the date of sale and the balance sheet date.