PLEASE ANSWER QUESTIONS 1-30 (MULTIPLE CHOICE) ON YOUR GREEN SCANTRON)

1. The risk that the auditors' procedures will lead them to conclude that a material misstatement does not exist in an account balance when in fact such a misstatement does exist is referred to as:
   A) Account risk.
   B) Control risk.
   C) Detection risk.
   D) Inherent risk.

2. Determining that receivables are presented at net-realizable value is most directly related to which management assertion?
   A) Existence or occurrence.
   B) Rights.
   C) Valuation or allocation.
   D) Presentation and disclosure.

3. An abnormal fluctuation in gross profit that might suggest the need for extended audit procedures for sales and inventories would most likely be identified in the planning phase of the audit by the use of:
   A) Tests of transactions and balances.
   B) An assessment of internal control.
   C) Specialized audit programs.
   D) Analytical procedures.

4. After obtaining an understanding of internal control and arriving at a planned assessed level of control risk, an auditor decided to perform tests of controls. The auditor most likely decided that:
   A) Additional evidence to support a reduction in the assessed level of control risk is not available.
   B) An increase in the assessed level of control risk is justified for certain financial statement assertions.
   C) It would be efficient to perform tests of controls that would result in a reduction in planned substantive tests.
   D) There were many internal control deficiencies that would allow misstatements to enter the accounting system.
5. Which of the following is least likely to be evidence on operating effectiveness?
A) Cancelled supporting documents.
B) Confirmations of accounts receivable.
C) Records documenting usage of computer programs.
D) Signatures on authorization forms.

6. Which of the following is not ordinarily a procedure for documenting an auditor's understanding of internal control for planning purposes?
A) Checklist.
B) Flowchart.
C) Questionnaire.
D) Confirmation.

7. Which is most likely when the assessed level of control risk increases?
A) Change from performing substantive tests at year-end to an interim date.
B) Perform substantive tests directed inside the entity rather than tests directed toward parties outside the entity.
C) Use the maximum number of dual purpose tests.
D) Use a larger sample size for substantive tests.

8. The effectiveness of controls is not generally tested by:
A) Inspection of documents and reports.
B) Performance of analytical procedures.
C) Observation of the application of accounting policies and procedures.
D) Inquiries of appropriate client personnel.

9. During financial statement audits, the auditors' consideration of their clients' internal control is integral to both assessing control risk and to:
A) Assessing inherent risk.
B) Planning the audit.
D) Providing a reasonable basis for an opinion on compliance with applicable laws.

10. In the consideration of internal control, the effectiveness of the design of controls is tested by:
A) Flowcharts.
B) Tests of controls.
C) Substantive tests.
D) Decision tables.
11. After considering the client's internal control the auditors have concluded that it is well designed and is functioning as anticipated. Under these circumstances the auditors would most likely:
A) Cease to perform further substantive tests.
B) Reduce substantive tests in areas where the internal control was found to be effective.
C) Increase the extent of anticipated analytical procedures.
D) Perform all tests of controls to the extent outlined in the preplanned audit program.

12. There is a presumption that the auditor will not test 100% of the activity. In certain instances, the auditor will use her judgment in determining which items to select, while in others, the auditor will not use judgment. In such instances, the auditor is relying upon:
A) Judgmental sampling techniques
B) Statistical sampling techniques
C) Random number tables
D) Non-statistical sampling techniques

13. If an auditor is selecting a sample, the auditor must document:
A) How the items were selected, as well as the items selected in a fashion which can be reperformed
B) Only how the items were selected
C) Selection criteria is not necessary, but the specific items selected should always be documented
D) Who knows (ps, this is not a very wise answer)

14. An auditor's analytical procedures have revealed that the accounts receivable of a client have doubled since the end of the prior year. However, the allowance for doubtful accounts, as a percentage of accounts receivable remained about the same. Which of the following client explanations most likely would satisfy the auditor?
A) Credit standards were liberalized in the current year.
B) Twice as many accounts receivable were written off in the prior year as compared to this year.
C) A greater percentage of accounts were currently listed in the “more than 90 days overdue” category than in the prior year.
D) The client opened a second retail outlet in the current year and its credit sales approximately equaled the older, established outlet.
15. Tracing recorded sales transactions in the sales journal to the shipping documents (bills of lading) provides evidence about the:
A) Completeness of recording of sales transactions.
B) Occurrence of sales transactions.
C) Billing of all sales transactions.
D) Presentation of payables.

16. In October, three months before year-end, the bookkeeper erroneously recorded the receipt of a one year bank loan with a debit to cash and a credit to miscellaneous revenue. Select the most effective method for detecting this type of error.
A) Foot the cash receipts journal for October.
B) Send a bank confirmation as of year-end.
C) Prepare a bank reconciliation as of year-end.
D) Prepare a bank transfer schedule as of year-end.

17. Which of the following manipulations of cash transactions would overstate the cash balance on the financial statements?
A) Understatement of outstanding checks.
B) Overstatement of outstanding checks.
C) Understatement of deposits in transit.
D) Overstatement of bank services charges.

18. As one of the year-end audit procedures, the auditor instructed the client's personnel to prepare a confirmation request for a bank account that had been closed during the year. After the client's treasurer has signed the request, it was mailed by the assistant treasurer. What is the major flaw in this audit procedure?
A) The confirmation request was signed by the treasurer.
B) Sending the request was meaningless because the account was closed before the year end.
C) The request was mailed by the assistant treasurer.
D) The CPA did not sign the confirmation request before it was mailed.

19. To gather evidence regarding the balance per bank in a bank reconciliation, an auditor could examine all of the following except:
A) Cutoff bank statement.
B) Year-end bank statement.
C) Bank confirmation.
D) General ledger.
20. Which of the following cash transfers results in a misstatement of cash at December 31, 19X7?

<table>
<thead>
<tr>
<th>Bank Transfer Schedule</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Disbursement</strong></td>
</tr>
<tr>
<td>Recorded in books</td>
</tr>
<tr>
<td>A) 12/31/X7</td>
</tr>
<tr>
<td>B) 1/4/X8</td>
</tr>
<tr>
<td>C) 12/31/X7</td>
</tr>
<tr>
<td>D) 1/4/X8</td>
</tr>
</tbody>
</table>

A) Entry A  
B) Entry B  
C) Entry C  
D) Entry D

21. Which of the following statements is true about materiality:
A) An item impacting net income by an immaterial dollar amount (less than 5% of net income) is not material.  
B) An item which would impact the decision of a reasonable financial statement user is material regardless of its dollar impact.  
C) Materiality is based on both quantitative and qualitative factors.  
D) Both B and C are true.

22. Audit planning should be performed:
A) At the beginning of the engagement.  
B) Prior to performing any substantive audit procedures.  
C) At the beginning of the engagement and updated continuously based on information obtained during the performance of the audit.  
D) Prior to performing any substantive audit procedures and prior to assessing control risk.

23. Which of the following factors most likely would cause a CPA to **not** accept a new audit engagement?
A) The prospective client has fired its prior auditor.  
B) The CPA lacks a thorough understanding of the prospective client's operations and industry.  
C) The CPA is unable to review the predecessor auditor's working papers.  
D) The prospective client is unwilling to make financial records available to the CPA.
24. Which of the following would most likely lead an auditor to conclude that a potential audit engagement should be rejected?
A) The details of certain transactions are not maintained online.
B) Internal control is likely to allow certain types of misstatements.
C) It is unlikely that sufficient competent evidential matter will be available.
D) Management has a reputation for consulting with several accounting firms about significant accounting issues.

25. Which of the following would heighten an auditor's concern about the risk of fraudulent financial reporting?
A) Inability to generate positive cash flows from operations, while reporting large increases in earnings.
B) Management's lack of interest in increasing the dividend paid on common stock.
C) Large amounts of liquid assets that are easily convertible into cash.
D) Inability to borrow necessary capital without obtaining waivers on debt covenants.

26. To best test existence, an auditor would sample from the:
A) General Ledger to source documents.
B) General Ledger to the financial statements.
C) Source documents to the general ledger.
D) Source documents to journals.

27. Which of the following is correct concerning requirements about auditor communications about fraud?
A) Fraud that involves senior management should be reported directly to the audit committee regardless of the amount involved.
B) All fraud with a material effect on the financial statements should be reported directly by the auditor to the Securities and Exchange Commission.
C) Fraud with a material effect on the financial statements should ordinarily be disclosed by the auditor through use of an "emphasis of a matter" paragraph added to the audit report.
D) The auditor has no responsibility to disclose fraud outside the entity under any circumstances.

28. Audits of financial statements are designed to obtain reasonable assurance of detecting material misstatements due to:
A) Errors: Yes; Fraudulent financial reporting: Yes; Misappropriation of assets: Yes
B) Errors: Yes; Fraudulent financial reporting: Yes; Misappropriation of assets: No
C) Errors: Yes; Fraudulent financial reporting: No; Misappropriation of assets: No
D) Errors: Yes; Fraudulent financial reporting: No; Misappropriation of assets: Yes
29. When a company has changed auditors, according to the Professional Standards:
A) The successor auditor has the responsibility to initiate contact with the predecessor auditor to ask about the client before the engagement is accepted; the predecessor has no responsibility to initiate this contact, even when aware of matters bearing on the integrity of management.
B) The predecessor must respond fully to all inquiries made by the successor auditor.
C) The successor must discuss with the predecessor matters bearing on the engagement prior to accepting the engagement.
D) The successor may choose not to attempt any communication with the predecessor auditor.

30. Which of the following is an example of fraudulent financial reporting?
A) Company management falsifies inventory count tags thereby overstating ending inventory and understating cost of goods sold.
B) An employee diverts customer payments to his personal use, concealing his actions by debiting an expense account, thus overstating expenses.
C) An employee steals inventory and the "shrinkage" is recorded in cost of goods sold.
D) An employee "borrows" tools from the company and neglects to return them; the cost is reported as a miscellaneous operating expense.

PLEASE ANSWER THE REMAINING QUESTIONS IN YOUR BLUE-BOOKS.

31. For this question, assume that the company is a public company registered with the PCAOB. Describe the requirements for the composition of the audit committee. Then describe their responsibilities.

32. List the factors to be considered in evaluating the control environment.

33. List the four broad categories of "control activities"

34. Management might be extremely committed to internal controls, yet it has been stated that it is impossible to create an infalable control system. Please list some reasons why this is the case.

35. Briefly describe and contrast the difference between a reportable condition and a material weakness.
To whom are these items presented (assume a public company)
36. State what is the definition of "material". Include guidance on the consideration of _____ and _____ factors (hint: both words start with the letter "q")

37. An audit does not require testing everything that happened, in fact the auditor's opinion specifically states so in the second paragraph. What does the auditors opinion state to support this assertion?
Answer Key

1. C
2. C
3. D
4. C
5. B
6. D
7. D
8. B
9. B
10. B
11. B
12. B
13. A
14. D
15. B
16. B
17. A
18. C
19. D
20. B
21. D
22. C
23. D
24. C
25. A
26. A
27. A
28. A
29. A
30. A
31. The audit committee must be comprised of INDEPENDENT members of the BOD. It must have one FINANCIAL EXPERT.

Their responsibilities include:
- Appointment of the auditors and their fees
- Receiving required communications from the auditors
- Oversee internal audit if there is one.
- Many others- general oversight of the financial statements
32. Integrity and ethical values
   Commitment to competence
   Human resources
   Assignment of authority and responsibility
   Management philosophy and operating style
   Board of directors or audit committee
   Organizational structure

33. Performance reviews
   Information processing
   Physical controls
   Segregation of duties

34. - Human error
   - Collusion
   - Management override
   - Deterioration over time
   - Things change, technology, business that you are in, etc.

35. A reportable condition is something of sufficient significance that the auditor is compelled to tell
    the audit committee about it. A material weakness is a reportable condition in which the design
    or operation of one or more of the internal control components does not reduce to a relatively
    low level the risk that misstatements caused by error or fraud in amounts that would be material
    in relation to the financial statements being audited may occur and not be detected within a
    timely period by employees in the normal course of performing their assigned functions.

    The difference between a reportable condition and a material weakness is that a material
    weakness is a reportable condition in which the condition could result in a material
    misstatement which the company would not detect.

36. Material is any item which would impact the decision making of a reasonable financial
    statement user. Materiality considers both quantitative as well as qualitative
    characteristics. Consequently an item which may appear to be of an immaterial dollar
    or percentage magnitude would still be material if it would alter the decision making of
    a user.

37. An audit includes examining evidence ON A TEST BASIS supporting the amounts and
    disclosures in the financial statements.