1. Which of the following statements is/ are accurate.
   A) Once an auditor accepts a client, future analysis of engagement risk is unnecessary;
   B) Each year, the auditor should reassess the engagement risk of an existing client;
   C) When accepting a new client, the auditor should contact the predecessor auditing firm;
   D) When accepting a new client, the auditor should contact the prospective client's bankers
      and attorneys.
   E) All but (A) above are accurate.

2. During audit planning, the auditor seeks to make a preliminary assessment of the risk of
   significant misstatement (ROSM), which is comprised of:
   A) Inherent risk and detection risk;
   B) Detection risk and control risk;
   C) Control risk inherent risk and detection risk;
   D) Inherent risk and control risk;

3. Under SEC Staff Accounting Bulletin No. 99, materiality assessments should include
   consideration of:
   A) Qualitative factors only;
   B) Quantitative factors only;
   C) Both Qualitative and Quantitative factors;
   D) Neither Qualitative nor Quantitative factors.

4. To qualify as "principal auditor" and render an opinion on the financial statements of a
   company, the auditor must:
   A) Audit at least 50% of the assets, revenues, equity and net income of the company, and
      reference the audits of other firms if they are relying upon the audits performed by other
      auditors;
   B) Audit all of the assets, revenues, equity and net income. It is inappropriate to reference
      or rely upon the audits of other firms.
   C) Audit at least 50% of the assets, revenues, equity and net income of the company, and
      need not reference the audits of other auditors if those audits were not relied upon
      (including if the principal auditor performed procedures themselves despite the other
      auditors work);
   D) Both A & C
5. Auditors must assess fraud risk on every audit and respond to the risks that are identified. Which of the following is not a procedure required to further address the fraud risk of management override of internal control?
A) Reviewing accounting estimates for biases.
B) Examining physical controls over assets.
C) Evaluating the business rationale for significant unusual transactions.
D) Examining journal entries and other adjustments for evidence of fraud.

6. The management assertion which is most difficult to obtain substantive support for is __ and is mitigated by ______.
A) Valuation of liabilities and expenses; mitigated by the search for unrecorded liabilities
B) Completeness of liabilities and expenses; mitigated by the search for unrecorded liabilities
C) Completeness of liabilities and expenses; mitigated by the analysis of doubtful accounts
D) Rights and obligations of assets; mitigated by the bank reconciliation review

7. Many companies have strong internal control processes, but those are not well documented, easily tested or related to financial reporting. This is a result of, and the impact to the auditor is:
A) Years of operating their business in the most productive way possible- but does not lend to controls the auditor may rely upon;
B) Governmental regulation- allowing reliance by the auditor;
C) Striving to have an easy audit- allowing reliance by the auditor;
D) None of the above.

8. We are auditing XYZ, Co. and discover a fraud risk related to retail store employees giving free merchandise to their friends. The auditors determine that the risk of material misstatement due to this fraud risk is low and that XYZ, Co. has taken appropriate measures to reduce this fraud risk to the greatest extent possible and that they have taken measures to account for the "shrinkage" resulting from this fraudulent activity. Which of the following statements is most accurate regarding how the auditor should proceed relative to this fraud risk factor:
A) The auditor should update their planning to incorporate this factor (if not already identified during planning), but based on the likelihood of misstatement and the measures already taken by management, is not obligated to do anything further.
B) The auditor should immediately resign from the engagement and notify the audit committee of the reason for their resignation;
C) The auditor should immediately resign from the engagement and notify the department of justice of the reason for their resignation;
D) The auditor should continue as if nothing happened as they are only responsible for material misstatements.
9. Which of the following would be least likely to be included in an auditor's tests of controls?
A) Inspection.
B) Observation.
C) Inquiry.
D) Confirmation.

10. Which of the following audit tests would be regarded as a test of a control?
A) Tests of the specific items making up the balance in a given general ledger account.
B) Tests confirming receivables.
C) Tests of the signatures on canceled checks to board of director's authorizations.
D) Tests of the additions to property, plant, and equipment by physical inspection.

11. A primary purpose of the auditor's consideration of internal control is to provide a basis for:
A) Determining whether procedures and records that are concerned with the safeguarding of assets are reliable.
B) Constructive suggestions to clients concerning improvements in internal control.
C) Determining the nature, extent, and timing of audit tests to be applied.
D) The expression of an opinion on compliance with laws and regulations.

12. The scope of substantive tests as compared to the scope of tests of controls generally vary:
A) In a parallel manner.
B) Inversely.
C) Directly.
D) Equally.

13. 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.
14. 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)

15. 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

16. When the auditors have decided to use statistical rather than nonstatistical sampling, a disadvantage is that:
A) Designing efficient samples is more difficult.
B) The costs of training staff may be higher.
C) Sampling without replacement must be used.
D) Objectively evaluating results is impossible.

17. When using sampling for tests of controls, which of the following audit consequences may follow?
A) If sample results indicate that the control is operating effectively, but in fact it is not, control risk will be assessed too low.
B) If sample results indicate that the control is operating effectively, but in fact it is not, control risk will be assessed too high.
C) If sample results indicate that the control is not operating effectively, but in fact it is operating effectively, the audit is likely to be faulty because of reduced substantive tests.
D) If sample results indicate that the control is not operating effectively, but in fact it is operating effectively, control risk will be assessed too low.

18. Which of the following is intended to detect deviations from prescribed controls?
A) Substantive tests specified by a standardized audit program.
B) Tests of controls designed specifically for the client.
C) Analytical procedures as designed in the industry audit guide.
D) Computerized analytical procedures tailored for the configuration of the computer equipment in use.
19. 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></td>
</tr>
<tr>
<td>Disbursement</td>
</tr>
<tr>
<td>Recorded in books</td>
</tr>
<tr>
<td>Paid by bank</td>
</tr>
<tr>
<td>Recorded in books</td>
</tr>
<tr>
<td>Received by bank</td>
</tr>
<tr>
<td>A) 12/31/X7 1/4/X8 12/31/X7 1/4/X8</td>
</tr>
<tr>
<td>B) 1/4/X8 1/5/X8 12/31/X7 1/4/X8</td>
</tr>
<tr>
<td>C) 12/31/X7 1/5/X8 12/31/X7 1/4/X8</td>
</tr>
<tr>
<td>D) 1/4/X8 1/11/X8 1/4/X8 1/4/X8</td>
</tr>
</tbody>
</table>

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

20. 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.

21. 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.
22. Jones was engaged to audit the financial statements of Gamma Corporation for the year ended June 30, 200X. Having completed an examination of the investment securities, which of the following is the best method of verifying the accuracy of recorded dividend income?
A) Tracing recorded dividend income to cash receipts records and validated deposit slips.
B) Utilizing analytical techniques and statistical sampling.
C) Comparing recorded dividends with amounts appearing on federal information form 1099s.
D) Comparing recorded dividends with a standard financial reporting service's record of dividends.

23. Which of the following is not confirmed on the standard form used for cash balances at financial institutions?
A) Cash checking account balances.
B) Cash savings account balances.
C) Loans payable.
D) Securities held for the client by the financial institution.

24. 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.

25. Jones embezzled $10,000 from his company's account in Bank A. At year-end he hid the shortage by making a deposit on December 31 in Bank A, drawn on Bank B. He has not recorded the transaction on the books. This is an example of:
A) Lapping.
B) Kiting.
C) Effective cash management.
D) Related party transactions.

SWITCH TO YOUR BLUE BOOK TO ANSWER THE REMAINING QUESTIONS PLEASE.
26. Pull together the relationship between risk assessments and auditing procedures. Construct your answer to address the following questions while describing the overall approach to auditing:

Why does the auditor apply planning procedures?
Why does the auditor seek to obtain an understanding of the control environment?
What is a preliminary control risk assessment?
Why is inherent risk assessment important?
What is meant by the term risk of significant misstatement (ROSM)?
Does an auditor always have to perform tests of operating effectiveness of controls (TOE's)?- ignoring SOX 404 requirement.
What are substantive procedures? You may use examples, but not necessary to list them all.
What is the relationship between TOE's and substantive procedures?
Which form of substantive procedure is REQUIRED during every audit? During what phase?
Once planning is completed, are the related risk assessments and planned audit procedures "locked"?

27. 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?

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

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

30. When considering risks due to fraud, there are two broad types of fraud which the auditor considers. What are they?

31. Explain what is meant by the term "interim audit procedures". Describe why such procedures may be appropriate, and include what aspect of required reporting by public companies significantly lends to the efficiency of performing interim audit procedures.
32. For this question, assume that the company is a public company registered with the PCAOB.

I. Describe the requirements for the composition of the board of directors and the audit committee.
II   Describe the responsibilities of the audit committee.
III  Must any members of the BOD be independent? Why?
Answer Key

1. E
2. D
3. C
4. D
5. B
6. B
7. A
8. A
9. D
10. C
11. C
12. B
13. B
14. A
15. B
16. B
17. A
18. B
19. B
20. D
21. C
22. D
23. D
24. A
25. B
26. Auditors perform planning for two primary reasons (1) it is required under GAAS and (2) it assists in determining the form and extent of the audit procedures to be applied. During planning, the auditor is required to obtain a sufficient understanding of the control environment to make a preliminary assessment of the control risk. The auditor also makes preliminary assessment of inherent risk. The inherent risk is the risk that misstatements will occur based on factors such as the complexity of the company's activities, degree of judgment required for their transactions, degree of complexity of related accounting literature and other factors. Combined, the inherent risk and control risk enable the auditor to make preliminary assessment of ROSM for each of management's assertions in the financial statements. Once preliminary ROSM's are assessed, the auditor can plan the remainder of the engagement, which includes the extent of testing the operating effectiveness of internal controls and the form and extent of the remaining substantive procedures to be applied.

Testing of internal controls is not required UNLESS the auditor plans to rely upon those controls. If the auditor does not plan to rely upon controls, or does not test controls for any reason, then the control risk assessment should be placed at high. However, the better the client internal control environment is, the less substantive audit procedures which may be necessary to complete the audit. Consequently it may be beneficial in a strong control environment for the auditor to test the operating effectiveness (apply TOE's) of the client controls. Generally, the stronger the client controls and the more TOE's applied, the less substantive testing required.

Substantive procedures are those designed to test the data recorded in the financial statements. They are the culmination of the process and based on where the auditor believes the risk lies. Substantive procedures include (1) documentary evidence (2) physical examination (3) accounting information system (4) analytics (computations and data interrelationships) (5) client representation. As discussed above, the stronger the controls and the greater the ability to rely upon those controls by the auditor, the less work need to be performed using substantive procedures. Analytics are a substantive procedure which is required on every engagement because GAAS requires them as a component of planning and wrapping up the engagement.

Planning is not complete until the audit opinion is rendered. Anything that the auditor learns during the course of the audit which impacts preliminary planning assessments and planned procedures must be considered... planning updated, and if procedures to be applied were not sufficient based on this new information, additional procedures/modifications may become required.

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

28. Performance reviews
   Information processing
   Physical controls
   Segregation of duties
29. 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

30. (1) Fraudulent financial reporting (or management fraud)
    (2) Misappropriation of assets (or defalcations, or theft)

31. Interim audit procedures means that the auditor is performing substantive and/or TOE's during the year, as opposed to waiting for the year to close prior to commencing any audit procedures.

Such technique is appropriate to avoid year end surprises to the company. Also, there is a conflict in all of the firms clients requiring audits at the same time. By spreading the work out, the audit firm better enables their ability to complete all of the required work in time for required filing deadlines by their clients.

Public companies are required to have their quarterly financial statements (10-Q's) reviewed. Due to this requirements, the auditor must be involved at least quarterly anyway and frequently performing audit procedures greater than what is necessary to complete a "review" is cost and time effective.

32. I The Board of directors must include 5 members who are "financially literate".
   II The audit committee must be comprised of 3 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

   III There is no specific requirement that the BOD be independent, however as 3 of the members of the audit committee must be also on the BOD, and all audit committee members must be independent, then at least 3 of the BOD members must be independent.