1. 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

2. 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

3. 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.
4. 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.

5. 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.

6. 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.

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. The auditor discovers that there is a circumstance which could produce more than an inconsequential error in an amount which could have a material impact to the financial statements. Which statement below is true relative to this finding:
A) There is a reportable condition which must be reported to the audit committee.
B) There is a material weakness which the auditor should notify the SEC about directly.
C) There is a reportable condition which the auditor should submit to the FBI and Joint Terrorism Task Force.
D) There is a material weakness which must be reported to the audit committee.
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. Tests of controls are most likely to be performed when:
   A) Controls seem weak and must be properly documented.
   B) The auditor is lazy.
   C) The auditor wishes to assess control risk at the maximum.
   D) The client's control environment appears strong and reliance may reduce substantive testing.

11. Of the following statements about internal control, which one is not valid?
   A) No one person should be responsible for the custodial responsibility and the recording responsibility for an asset.
   B) Transactions must be properly authorized before such transactions are processed.
   C) Because of the cost/benefit relationship, a client may apply control procedures on a test basis.
   D) Control activities reasonably insure that collusion among employees can not occur.

12. 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.

13. 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.
14. 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.

15. Which of the following would be least likely to be regarded as a test of a control?
   A) Tests of the additions to property by physical inspection.
   B) Tests of the signatures on cancelled checks to the authorized check signer list.
   C) Tests of signatures on purchase orders.
   D) Recalculation of payroll deductions.

16. 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

17. 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)

18. Statistical sampling may be used to test:
   A) Qualitative characteristics, such as test of operating effectiveness of controls
      ONLY;
   B) Quantitative characteristics, such as substantive tests of details ONLY
   C) Both qualitative and quantitative characteristics- both TOE's and substantive tests of
      details
   D) None of these
19. Which of the following is not generally used for selecting samples?
   A) Random number tables.
   B) Random number generators.
   C) Physical representation numbers.
   D) Systematic selection.

20. 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;

21. Which of the following factors most likely would heighten an auditor's concern about the risk of fraudulent financial reporting?
   A) Large amounts of liquid assets that are easily convertible into cash.
   B) Low growth and profitability as compared to other entity's in the same industry.
   C) Financial management's participation in the initial selection of accounting principles.
   D) An overly complex organizational structure involving unusual lines of authority.

22. 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.
23. An internal control questionnaire indicates that an approved receiving report is required to accompany every check request for payment of merchandise. Which of the following procedures provides the best evidence on operating effectiveness?

A) Select and examine receiving reports and test whether the related canceled checks are dated no earlier than the receiving reports.
B) Select and examine receiving reports and test whether the related canceled checks are dated no later than the receiving reports.
C) Select and examine canceled checks and test whether the related receiving reports are dated no earlier than the checks.
D) Select and examine canceled checks and test whether the related receiving reports are dated no later than the checks.

24. Which of the following statements is **not** correct?

A) Cash is important to the audit process because of its vulnerability to misappropriation, despite the fact that the balance at the balance sheet date may be immaterial.
B) Even though the year end cash balance can be verified by vouching to the bank statement, confirmations should still be sent directly to the bank and include additional questions about restrictions upon the cash and any financing arrangements with the bank.
C) Confirmation of cash need not be performed if the bank statement agrees to the bank reconciliation which reconciles the bank balance to the balance recorded in the general ledger.
D) Reviewing interbank transfers is important to the auditor because of the possibility that the client may be engaged in kiting or mistakenly have reported only one side of a transfer between bank accounts.

25. Which of the following is **not** a factor that is considered in evaluating a client's overall control environment?

A) The organizational structure.
B) The information system.
C) Management philosophy and operating style.
D) Board of directors.

26. Control risk assessment of an auditor, by default should be assessed at what level? In order to deviate from that level the auditor must do what?
27. (A) Discuss the importance of reviewing minutes to meetings of the Board of directors, investment committee, audit committee and other committees.
(B) What process is generally employed in the filing of minutes that significantly lends to their credibility?
(C) Using derivative financial instruments as a specific example, please state why a review of the investment committee minutes is important.
(D) What did Bob Anderson learn by review of minutes that the client did not inform him of and which could have resulted in a free trip to Hawaii?

28. Discuss the valuation assertion as it relates to the audit of (1) investments in available for sale securities and (2) cash

29. (A) 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 auditor's opinion state to support this assertion?
(B) Can you select a "random" sample using your fingers and toes, why or why not?
(C) When selecting less than 100% from a population, you are using one of two broad categories of sampling, what are they?
(D) In each of the following scenarios, what type of sampling would be appropriate?
   1) Real estate company that closed only 5 sales in a year and which each is material;
   2) A population of 10,000 items where 3 of those items represent 98% of the dollar impact of the population;
   3) A population of 10,000 items where each of those items are similar and individually immaterial.
(E) Why should an auditor consider the nature/cause of a deviation when sampling (two primary reasons stated in lecture)
(F) If an item selected as a sample can not be located, how should the auditor treat that item?

30. What are the factors of a control environment. Hint there are 7 of them and the memory device sounds like "I CHAM BOUGH"
31. In many instances, as a result of the required audit of financial reporting controls under the Sarbanes Oxley Act, it was discovered that while many companies had strong internal controls, they were not well documented, and not necessarily catered to financial reporting. Please discuss this finding, and include how the concerns of management (including naming the types of risks they seek to manage) may overlap with auditor considerations (and name the auditor risk assessments and how they are impacted).

I WOULD LIKE YOU TO KNOW THAT (A) I am a nice guy and even though I have written a creative simulation, I decided it caused the exam to be impossible to complete in an hour and fifteen minutes. This means that this exam is too short and I will have to live with that. I also want you to know that I WILL use that simulation on the final.
Control risk is High unless the auditor identifies controls which may be relied upon to reduce the risk AND performed Tests of Operating Effectiveness (TOE's) to justify reliance upon those controls. Only if these procedures are performed should an auditor assess control risk at less than HIGH.

27. (A) Completeness is difficult to test. By reviewing the minutes of meetings, the auditor becomes aware of important decisions and actions that they may not otherwise know of. (B) Each new meeting should include the approval of the minutes of the prior meeting thus making all members present in agreement on the accuracy and completeness of those minutes. (C) A derivative financial instrument may not result in a cash receipt/outlay until a future date. Consequently, the auditor has no transaction which may alert them to the existence of a derivative financial instrument. Minutes should indicate approval to enter such a transaction and would thus identify the item by auditor review of the minutes. (D) There was a guarantee of the debt of an affiliate which the client did not disclose that was identified.
28. (1) AFS investments are carried at fair value which requires application of judgment by management and consequently the valuation assertion is of great interest to the auditor.

(2) Cash is the only item on the balance sheet where the auditor is not concerned with the valuation assertion as the cash is already converted to cash!

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

(B) NO, it requires statistical procedures such as a random number generator, software, etc.

(C) (1) Statistical or (2) Judgmental

(D) (1) Will accept either Judgmental or NO sampling/ 100%

(2) Judgmental

(3) Statistical

(E) (1) It helps the auditor understand the prevalence and risk of repeated exceptions

(2) It may enable the auditor to provide constructive comments to the client earning a better more meaningful auditor/client relationship.

(F) It should be treated as a deviation/ completely incorrect.

30. Integrity and ethical values
Commitment to competence
Human resource policies and practices
Assignment of authority and responsibility
Management philosophy and operating style
Board of directors or audit committee

Organizational structure

31. Management of businesses seek to mitigate the BUSINESS RISKS and do so by implementing various controls. Because management is not doing this to prove to an auditor or anyone else that they did it, but to actually manage a risk, it is more important to management that the control mitigate the risk than that there be a detailed record of performance. In managing BUSINESS RISKS, management many times is managing INHERENT RISKS, which are relevant to audit planning and auditor risk assessments. The controls that the client puts in place impact the auditors CONTROL RISK assessment. While management may not be able to impact the existence of an inherent risk, they may be able to mitigate the risk, thereby reducing the auditor CONTROL RISK ASSESSMENT. Therefore by managing inherent risks with controls, the ROSM may be reduced.