1. In general, which of the following statements is correct with respect to ownership, possession, or access to working papers prepared by a CPA firm in connection with an audit?
   A) The working papers are subject to the privileged communication rule which, in a majority of jurisdictions, prevents third-party access to the working papers.  
   B) The working papers are the property of the client after the client pays the fee.  
   C) The working papers must be retained by the CPA firm for a period of ten years.  
   D) The working papers may be obtained by third parties where they appear to be relevant to issues raised in litigation.

2. The determining factor in how much audit work is necessary for an audit engagement is dictated by:
   A) Specifically defined by the AICPA  
   B) The 8 inch binder rule.  
   C) The PCAOB  
   D) Judgment of the auditor

3. Public companies are required to have their internal controls audited under this requirement:
   A) ERISA Act of 1986  
   B) Sarbanes-Oxley Act Section 404  
   C) Internal Revenue Code section 401(k)  
   D) Sarbanes-Oxley Act Section 403(a)

4. Competence as a certified public accountant includes all of the following except:
   A) Warranting the infallibility of the work performed.  
   B) Having the technical qualifications to perform an engagement.  
   C) Consulting others if additional technical information is needed.  
   D) Possessing the ability to supervise and to evaluate the quality of staff work.

5. The review of a company's financial statements by a CPA firm:
   A) Culminates in issuance of a report expressing the CPA's opinion as to the fairness of the statements.  
   B) Is of similar scope as an audit and adds similar credibility to the statements.  
   C) Is substantially less in scope of procedures than an audit.  
   D) Requires detailed analysis of the major accounts.

6. Management has centralized purchasing and uses a model based upon previous year's
sales with adjustments for trends in the market place, e.g., the trend to more casual shoes. A staff auditor has suggested that the centralized purchasing may be one of the reasons for the lower level of profitability in the Mid-Central Region. Which of the following would be the best single audit procedure to address the staff auditor's assertion?

A) Perform a product-line analysis of sales and purchases in the Mid-Central Region and compare with other regions.
B) Perform an inventory count at selected stores in the Mid-Central Region and determine if adjustments are needed to the perpetual records.
C) Take a sample of receiving documents at stores and trace to purchase orders to determine the length of time between the purchase and delivery of the goods.
D) Interview store managers in the Mid-Central Region to determine their attitude toward centralized purchasing.

7. When using a specialist, an auditor must
A) Review and understand the report of the specialist
B) Test the data provided to the specialist
C) Satisfy herself that the specialist is qualified for the subject area
D) All of the above

8. The client operates in a rapidly emerging industry where large complex contracts are executed with their customers. The recognition of revenue requires the application of a complex accounting standard and involves much subjectivity. Which risk below is certainly high relative to the above information?
A) Detection risk    B) Inherent risk    C) Audit risk    D) Control risk

9. In the list below, who is not a covered member relative to an audit of XYZ, Inc. performed by Auditors, LLP
A) Professional staff of Auditors, LLP working directly on the audit of XYZ, Inc.
B) Administrative assistant who works at Auditors, LLP
C) A partner of Auditors, LLP who works in the office out which the audit is performed.
D) The partner above's spouse.

10. The generally accepted auditing standards adopted by the AICPA include a requirement that the CPAs:
A) Exercise due professional care in the performance of the examination and the preparation of the report.
B) Assume responsibility for any losses to the client from fraud which existed during the audit but was not detected by the auditors.
C) Follow accounting principles adopted by the SEC.
D) Not accept as audit clients companies which compete directly with one another.
11. The provisions of the Sarbanes-Oxley Act of 2002 are most likely to allow which of the following non-audit services for audit clients?
   A) Financial information systems design and implementation.
   B) Tax consulting.
   C) Appraisal or valuation services (e.g., pension, post-employment benefit liabilities).
   D) Internal audit outsourcing.

12. An audit of a public company includes two opinions, and is referred to as:
   A) Only an opinion on the conformity of the financial statements with GAAP and is referred to as an integrated audit.
   B) Opinion on the forward looking information included in MD&A as well as the conformity of the financial statements to GAAP and is referred to as an examination.
   C) Opinions on the conformity of the financial statements with GAAP and the internal controls, and is referred to as an integrated audit.
   D) Only an opinion on the conformity of the financial statements with GAAP and is referred to as a PCAOB audit.

13. From the options below, select the form of audit evidence which is the least "reliable"
   A) Client representations
   B) Third party confirmations
   C) Information provided by the accounting information system
   D) Physical evidence

14. With respect to auditing management's fair value estimates, which is the most compelling source of information to the auditor when available:
   A) Independant estimation by the auditor using data available as of the balance sheet date
   B) Subsequent events and transactions bearing upon the estimate.
   C) Recomputation
   D) 976-psych

15. A "close relative" of yours may not:
   A) Hold any direct investment in an audit client of yours
   B) Work at an audit client of yours in a key position
   C) Invest in a mutual fund which holds an indirect interest in an audit client of yours
   D) Get their car insurance from a company which is an audit client of yours

16. Although the quantity, type, and content of working papers will vary with the
circumstances, the working papers generally would include the:
A) Auditor's comments concerning the efficiency and competence of client management personnel.
B) Copies of those client records examined by the auditor during the course of the engagement.
C) Auditing procedures followed and the testing performed in obtaining evidential matter.
D) Evaluation of the efficiency and competence of the audit staff assistants by the partner responsible for the audit.

17. The most stringent independence standards apply to:
   A) Covered members  B) Non-attest services  C) Close relatives  D) Employees

18. A procedure in which a quality control partner periodically tests the application of quality control procedures is most directly related to which quality control element?
   A) Personnel management.
   B) Monitoring.
   C) Engagement performance.
   D) Independence, integrity and objectivity.

19. If an auditing firm is not registered with the PCAOB, then:
   A) They are permitted to perform audits of non-public companies as long as they comply with AICPA standards.
   B) The auditors do not need to comply with PCAOB standards, nor allow oversight by the PCAOB
   C) They are not permitted to perform audits of public companies.
   D) All of the above.

20. Which of the following is not required by the generally accepted auditing standard that states that due professional care is to be exercised in the performance of the audit?
   A) Critical review of the audit work performed at every level of supervision.
   B) Responsibility for losses because of errors of judgment.
   C) Observance of the standards of field work and reporting.
   D) Degree of skill commonly possessed by others in the profession.

21. An audit provides reasonable assurance of detecting which of the following types of important illegal acts?
   A) Direct Effect: Yes; Indirect Effect: No  C) Direct Effect: No; Indirect Effect: No
   B) Direct Effect: No; Indirect Effect: Yes  D) Direct Effect: Yes; Indirect Effect: Yes
22. Requirements for training, independence and due professional care are included in which group of the generally accepted auditing standards?

23. Which of the following is not a typical analytical procedure?
   A) Comparison of the financial information with budgeted amounts.
   B) Study of relationships of the financial information with relevant nonfinancial information.
   C) Comparison of the financial information with similar information regarding the industry in which the entity operates.
   D) Comparison of recorded amounts of major disbursements with appropriate invoices.

24. Which of the following has the AICPA been most concerned with providing?
   A) Professional guidance for regulating financial markets.
   B) Standards guiding the conduct of internal auditors.
   C) Staff support to Congress.
   D) Professional standards for CPAs.

25. Select the BEST answer below. When conducting an audit, a difference is noted. The auditor should:
   A) Work with the appropriate client personnel first to ensure that the auditor has not made a mistake himself and to involve the client in the process.
   B) Notify the partner immediately
   C) Notify the FBI
   D) Include this on the summary of audit differences

26. Discuss the following relative to internal controls: (1) what are they (1a) what do they seek to do (2) auditors responsibility with respect to them under GAAS (3) what would cause internal controls to require auditing (4) what tests are performed when internal controls are tested

27. Accounting Principles Generally Accepted in the United States of America are established by the AICPA. There are 10 standards, which break into three categories. Please list the three categories and under each category, list the standards which apply to that category.

28. Management makes assertions in the financial statements and it is the auditor's responsibility to audit these assertions. Please list the "management assertions" (hint: 5 of them).
Which of these assertions generally has the highest risk and why?

With respect to liabilities, which assertion is generally the most important, and most difficult to test by an auditor?

29. Briefly describe how an audit difference which is a *small* difference relative to the size of the company can still be considered material.

30. In connection with an audit, we need you to develop expectations for the ending balances/12 month income/expense for a company. It is up to you to determine which balances and activity which you may be able to develop the expectation for. (even if your expectation is zero for a relevant component, please state so):

   *If you can estimate a dollar amount, do so, if you can only quantify in terms such as "materially comparable to prior year"," increase from prior year" etc... then do whatever is the best possible based upon the information available.*

I. The Company sold bonds many years ago, at the beginning of the year the balance outstanding was $10,000,000 with five years remaining until maturity. The interest rate is 12% which compounds monthly. Interest is paid each month at the end of the month and principal is repaid in one lump sum of $10,000,000 upon maturity.

II. The Company had the same number of employees as in the prior year, the vacation policy has not changed and salaries are materially consistent with the prior year. The company pays payroll on the last day of each month.

III. Last year the company owned five properties for which they paid property taxes. Each represented exactly 20% of the total property tax basis upon which those property taxes are levied. One of the properties was sold on June 30 of the current year. For this one, express your expectations as a % of the prior year. Property taxes are paid at the end of each 12 month period ending on October 1st.

31. During audit planning, the auditor seeks to identify the greatest risks of material misstatements (RMM). Please discuss:

   1. what are the risks that comprise the RMM.
   2. Briefly discuss what each of the risks you identified in (1) above, include in your response, what factors would impact the auditors assessment of each.
   3. What is the name of the risk that an audit difference will not be detected by the auditors?
   4. the combination of all the risks above is referred to as?
   5. This one is fun: GAAS requires planning *and* understanding internal controls. In
class it was briefly discussed that a requirement to understand internal controls is redundant given the planning requirement. Briefly explain why specifically requiring that an auditor obtain an understanding of internal controls appears redundant.
Answer Key

1. D
2. D
3. B
4. A
5. C
6. A
7. D
8. B
9. B
10. A
11. B
12. C
13. A
14. B
15. B
16. C
17. A
18. B
19. D
20. B
21. A
22. D
23. D
24. D
25. A
26. (1) Internal controls are procedures performed to manage risk.
   (1a) They seek to PREVENT and/or DETECT material misstatements. ALSO
        ANYTHING ABOUT MANAGING RISK.
   (2) The auditor is required to understand the internal controls, but not required to audit
        them. Even if the auditor is not planning to rely upon internal controls, the auditor still
        must obtain an understanding them.
   (3) If an auditor assesses control risk at less than high then internal controls will need to
        be tested.
        If it is an audit of a public company, then the auditor needs to test the controls/
   (4) TOD's & TOE's
27. General Standards:
   - PERFORMED BY PERSONS ADEQUATELY TRAINED AND PROFICIENT
   - INDEPENDENCE OF AUDITOR
   - EXERCISE DUE PROF. CARE

   Standards of Fieldwork:
   - ENGAGEMENT TO BE ADEQUATELY PLANNED
   - OBTAIN A SUFFICIENT UNDERSTANDING OF INTERNAL CONTROL
   - OBTAIN SUFFICIENT COMPETENT EVIDENTIAL MATTER
Standards of Reporting:
- STATE ACCORDANCE WITH GAAP
- IDENTIFY CIRCUMSTANCES WHERE PRINCIPLES HAVE NOT BEEN CONSISTENTLY APPLIED
- INFORMATIVE DISCLOSURES, UNLESS OTHERWISE NOTED IN OPINION
- EXPRESS AN OPINION OR STATE THAT AN OPINION CAN NOT BE MADE

28. Cutoff
   Existence
   Completeness
   Rights & Obligations
   Valuation
   Presentation and disclosure

   Valuation generally receives the most attention as it involves the most subjectivity, and consequently carries a high degree of inherent risk.

   Liabilities: Completeness is most crucial and most difficult to test.

29. An item which is immaterial from a QUANTITATIVE perspective may be material from a QUALITATIVE perspective if it is deemed to be relevant to the decision making of a financial statement user.

30. I. interest expense: $120,000 (12%*10,000,000)
    debt balance: $10,000,000 (principle due at maturity)
    accrued interest: $0 (pay interest at the end of the month as it accrues)

   II. Expect payroll expense to be materially comparable to prior year.
       Expect vacation accrual to be materially comparable to prior year.
       Expect vacation expense to be materially comparable to prior year.
       Expect accrued payroll to be $0 because they pay on the last day of the month (hence will pay on last day of the year)
       Expect payroll expenses to be materially comparable to prior year.

   III> Expect property tax expense to decline by 10% (20% for this property, but was sold in the middle of the year)
       Expect accrued property taxes to decline by 20% as the property sold was not held during any portion of the period which is accrued at year end.

31. (1) Inherent risk and Control risk
(2) Inherent risk is the potential that something could be wrong based upon the business of the company, for instance the complexity of the transactions, the complexity of the accounting rules, the degree a companies business is influenced by external factors, etc.

   Control risk is the potential that the client's internal controls would not detect a risk (or misstatement) which occurred.
(3) Detection risk
(4) Audit risk
(5) Because planning requires the assessment of RMM, and RMM is IR & CR...the control risk assessment must be made in order to identify the RMM's. In other words because GAAS required that RMM's be identified in planning an auditor must make control risk assessments.