ECON 132A SPRING 2008 MT#2

Name: __________________________ Perm #: _____________

ANSWER QUESTIONS#1-25 ON GREEN SCANTRON

ANSWER #26 & 27 IN THE SPACE PROVIDED.

SIMULATION: WRITE YOUR NAME ON THE SIMULATION ASSIGNMENT ITSELF, ANSWER IN YOUR BLUE BOOK AND PUT THE SIMULATION ASSIGNMENT IN THE BLUE BOOK WHEN YOU HAND IN YOUR EXAM PLEASE!!

1. Properly designed internal control will permit the same employee to:
   A) Sign checks, and also cancel supporting documents.
   B) Receive and deposit checks, and also approve write-offs of customer accounts.
   C) Approve vouchers for payment, and also receive and deposit cash.
   D) Reconcile the bank statements, and also receive and deposit cash.

2. As an auditor, when fraud is detected, you should:
   A) Report it to the Company, and regardless of its materiality or pervasiveness, the auditor is required to also report it to the Board of Directors
   B) Immediately report it to the FBI
   C) If it is immaterial, there is no need to report it to anyone
   D) Report it to the Company, unless committed by management, then report to the Board of Directors

3. Which of the following are benefits of statistical sampling?
   A) It helps the auditor to focus their time and attention to the areas of highest risk.
   B) It provides the auditor with a rational means of supporting the amount of work performed in the event that sufficiency of their work is called into question.
   C) Audit fees would not be reasonable if auditors had to audit 100% of all balances and activity.
   D) All of these answers are true.

4. Audit planning should be performed:
   A) Prior to performing any substantive audit procedures and prior to assessing control risk.
   B) At the beginning of the engagement.
   C) Prior to performing any substantive audit procedures.
   D) At the beginning of the engagement and updated continuously based on information obtained during the performance of the audit.
5. Which of the following is least likely to be evidence on operating effectiveness?
   A) Confirmations of accounts receivable.
   B) Records documenting usage of computer programs.
   C) Signatures on authorization forms.
   D) Cancelled supporting documents.

6. In the consideration of internal control the operating effectiveness of controls is tested by:
   A) Substantive tests.
   B) Flowcharts.
   C) Decision tables.
   D) Tests of controls.

7. Which of the following statements is accurate about "fraud risk factors" considered when conducting an audit?
   A) Factors whose presence will require modification to planned audit procedures.
   B) Factors whose presence indicates that fraud exists.
   C) Factors obtained during the audit which lead to required communications with the audit committee.
   D) Factors whose presence often have been observed in circumstances where frauds have occurred.

8. Which of the following topics is not normally included in an engagement letter?
   A) A description of responsibility for the detection of fraud.
   B) The auditors' preliminary assessment of internal control.
   C) The auditors' estimate of the fee for the engagement.
   D) Limitations on the scope of the engagement.

9. System controls are beneficial because many of the problems associated with humans can be avoided. If an auditor validates that a system control performed satisfactorily for a transaction, what else must the auditor do before relying upon that control in connection with the audit?
   A) TOE's
   B) Nothing
   C) TOD's
   D) TOD's & TOE's
10. A predecessor auditor is required to attempt to initiate communication with the successor auditor:
   A) Prior to the successor's acceptance of the engagement: No; Subsequent to the successor's acceptance of the engagement: Yes
   B) Prior to the successor's acceptance of the engagement: Yes; Subsequent to the successor's acceptance of the engagement: Yes
   C) Prior to the successor's acceptance of the engagement: No; Subsequent to the successor's acceptance of the engagement: No
   D) Prior to the successor's acceptance of the engagement: Yes; Subsequent to the successor's acceptance of the engagement: No

11. 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) Governmental regulation- allowing reliance by the auditor;
   B) Striving to have an easy audit- allowing reliance by the auditor;
   C) Years of operating their business in the most productive way possible- but does not lend to controls the auditor may rely upon;
   D) None of the above.

12. Statistical sampling may be used to test:
   A) Quantitative characteristics, such as substantive tests of details ONLY
   B) Both qualitative and quantitative characteristics- both TOE's and substantive tests of details
   C) Qualitative characteristics, such as test of operating effectiveness of controls ONLY;
   D) None of these

13. 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) Statistical sampling techniques
   B) Random number tables
   C) Non-statistical sampling techniques
   D) Judgmental sampling techniques
14. 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

15. What is most likely to identify a material misstatement in a financial statement?
   A) Tests of design
   B) Tests of operating effectiveness
   C) Tests of integrity
   D) Substantive audit procedures

16. Its a good idea for the mail-room to create a control listing of all checks received before forwarding the mail and checks to the appropriate department so that:
   A) The Company has a log which will be important for the bank reconciliation.
   B) The Company can validate the performance of internal controls.
   C) The Company can compare to the deposits to be sure all checks received are accounted for.
   D) The Company has a log in case a customer indicates that they sent a payment.

17. The auditor discovers that there is a circumstance which has more than a remote likelihood of occurrence, and while it would not produce a material misstatement, it could produce more than an inconsequential difference. Which statement below is true relative to this finding:
   A) There is a significant deficiency
   B) There is an un-reportable event
   C) The auditor should resign from the engagement.
   D) There is a material weakness
18. Under which circumstance is it likely that the extent of substantive procedures will be expanded beyond that anticipated in the audit plan?
   A) Deviation rates were greater than zero and approached anticipated levels.
   B) The operating effectiveness of certain controls was found to be less than expected, although no material misstatements were identified.
   C) Certain controls do not leave a trail of documentary evidence.
   D) The auditors have determined that controls have been placed in operation but, in accordance with the audit plan, have performed no tests of controls.

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

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

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

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

<table>
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<tr>
<th>Bank Transfer Schedule</th>
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<tbody>
<tr>
<td>Disbursement</td>
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<td>A) 12/31/X7</td>
</tr>
<tr>
<td>B) 1/4/X8</td>
</tr>
<tr>
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A) Entry D
B) Entry A
C) Entry B
D) Entry C

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

25. You have worked through an exhausting audit. You discovered many material adjustments, but they were all booked and consequently, you were able to render an unqualified opinion. Assuming that the client has an audit committee, what should be reported to them by you as the auditor?
A) A material weakness in the internal controls
B) A substantial deviation of internal controls
C) A significant deficiency in the internal controls
D) Consideration of internal controls is only required in connection with audits of public companies

26. List the four broad categories of "control activities"
27. List the factors to be considered in evaluating the control environment.
Answer Key

1. A
2. D
3. D
4. D
5. A
6. D
7. D
8. B
9. B
10. C
11. C
12. B
13. A
14. D
15. D
16. C
17. A
18. B
19. D
20. A
21. D
22. A
23. C
24. C
25. A
26. Performance reviews
   Information processing
   Physical controls
   Segregation of duties
27. 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
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14. A
15. D
16. D
17. C
18. C
19. B
20. C
21. B
22. B
23. B
24. D
25. D
26. 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
27. Performance reviews
   Information processing
   Physical controls
   Segregation of duties