Econ. 132 Final Exam Fall 2003

Instructions: Place answers to the multiple choice and true false questions on your scantron. Answers to all other questions are to be placed in your bluebook. Place the test version number on your scantron and the outside cover of your bluebook. When finished, turn in the testcopy, your scantron and bluebook.

1. Confirmations for cash balances should be mailed only to the financial institutions with which the client has a cash balance at year-end.

2. Which of the following types of matters do not generally require disclosure in the financial statements?
   A) Commitments.
   B) Loss contingencies.
   C) Liabilities to related parties.
   D) General risk contingencies.

3. Which of the following is not typically considered to be an alternate procedure for handling nonreplies to accounts receivable confirmations?
   A) Examine correspondence.
   B) Examine any subsequent cash receipts.
   C) Inclusion of the information in the engagement letter.
   D) Examine sales invoices.

4. An auditor should perform alternative procedures to substantiate the existence of accounts receivable when:
   A) Collectibility of the receivables is in doubt.
   B) No reply to a positive confirmation request is received.
   C) Pledging of the receivables is probable.
   D) No reply to a negative confirmation request is received.

5. The auditors use a bank cutoff statement to compare:
   A) Deposits listed on the cutoff statement to disbursements in the cash disbursements journal.
   B) Checks dated subsequent to year-end to the outstanding checks listed on the year-end bank statement.
   C) Checks dated prior to year-end to the outstanding checks listed on the year-end bank reconciliation.
   D) Deposits in transit on the year-end cash general ledger account to deposits in the cash receipts journal.

6. When there is a significant question about a company’s ability to remain a going concern, the report issued is usually unqualified with an explanatory paragraph.
7. Which of the following is a likely procedure to test the adequacy of the allowance for doubtful accounts?
A) Foot the receivables lead schedule.
B) Examine dates of purchase orders.
C) Age receivables.
D) Confirm receivables.

8. Which of the following is not a procedure normally performed while completing the audit?
A) Obtain a representations letter.
B) Obtain confirmation of capital stockholdings from shareholders.
C) Obtain a lawyer's letter.
D) Perform an overall review using analytical procedures.

9. A CPA examines a sample of copies of December and January sales invoices for the initials of the person who verified the quantitative data. This is an example of a:
A) Substantive test.
B) Cutoff test.
C) Statistical test.
D) Test of a control.

10. The fourth reporting standard requires the auditor's report to contain either an expression of opinion regarding the financial statements, taken as a whole, or an assertion to the effect that an opinion cannot be expressed. The objective of the fourth standard is to prevent:
A) Misinterpretations regarding the degree of responsibility that the auditor is assuming.
B) The CPA from reporting on one basic financial statement and not the others.
C) The CPA from expressing different opinions on each of the basic financial statements.
D) Management from reducing its final responsibility for the basic financial statements.

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

12. Tracing recorded sales transactions in the sales journal to the shipping documents (bills of lading) provides evidence about the:
A) Billing of all sales transactions.
B) Presentation of payables.
C) Occurrence of sales transactions.
D) Completeness of recording of sales transactions.

13. Which of the following is an analytical procedure that should be applied to the income statement?
A) Compare the actual revenues and expenses with the corresponding figures of the previous year and investigate significant differences.
B) Obtain from the proper client representatives, the beginning and ending inventory amounts that were used to determine costs of sales.
C) Select sales and expense items and trace amounts to related supporting documents.
D) Ascertain that the net income amount in the statement of cash flows agrees with the net income amount in the income statement.
14. The first paragraph of a standard unqualified audit report is referred to as the:
   A) Scope paragraph.
   B) Explanatory paragraph.
   C) Introductory paragraph.
   D) Opinion paragraph.

15. Your client left the cash receipts journal open after year-end for an extra day and included January 1 cash receipts in the 12/31/XX totals. All of those cash receipts were due to cash sales. Assuming the client uses a periodic inventory system with a 12/31/XX count of the physical inventory, which of the following is most likely to be true relating to the year XX financial statements?
   A) Inventory is overstated.
   B) Net income is overstated.
   C) Accounts receivable are understated.
   D) Sales are understated.

16. Which of the following is not a procedure that auditors typically perform to search for significant events during the subsequent period?
   A) Review changes in internal control during the period subsequent to the balance sheet date.
   B) Review minutes of board of directors' meeting.
   C) Review the latest available interim financial statements.
   D) Inquire about any unusual adjustments made subsequent to the balance sheet date.

17. The confirmation of accounts receivable is most closely associated with
   A) Relative risk.
   B) Inherent risk.
   C) Business risk.
   D) Detection risk.

18. Which procedure is an auditor most likely to use to detect a check outstanding at year-end that was not recorded as outstanding on the year-end bank reconciliation?
   A) Receive a cutoff statement directly from the client's bank.
   B) Confirm the year end balance using the standard form to confirm account balance information with financial institutions.
   C) Prepare a bank transfer schedule using the client's cash receipts and cash disbursements journal.
   D) Prepare a four column bank reconciliation using the year-end bank statement.

19. Which of the following is not a control that generally is established over cash transactions?
   A) Centralizing the receipt of cash.
   B) Obtaining a receipt for every disbursement.
   C) Separating cash handling from recordkeeping.
   D) Depositing each day's receipts intact.

20. Which of the following procedures would an auditor most likely perform while evaluating audit findings at the conclusion of an audit?
   A) Verify the clerical accuracy of the entity's proof of cash and its bank cutoff statement.
   B) Develop an estimate of the total likely misstatement in the financial statements.
   C) Obtain assurance from the entity's attorney that all material litigation has been disclosed in the financial statements.
   D) Determine whether reportable conditions have corrected.
21. Audit reports should be dated the date on which the financial statements are issued.

22. Auditors may use positive and/or negative forms of confirmation requests for accounts receivable. Of the following, which combination is it most likely that the auditors will use?  
   A) The positive form used for trade receivables and the negative form for other receivables.  
   B) The positive form for small balances, and the negative form for large balances.  
   C) The positive form when controls related to receivables are satisfactory, and the negative form when controls related to receivables are unsatisfactory.  
   D) The positive form used for large balances and the negative form for the small balances.

23. The audit of which of the following balance sheet accounts does not normally result in verification of an income statement account?  
   A) Intangible assets.  
   B) Property, plant and equipment.  
   C) Cash.  
   D) Accounts receivable.

24. Confirmation requests should contain a "business reply" envelope addressed to the auditors at the client's address.

25. Mailroom personnel of a company should prepare a control listing of incoming cash receipts and deposit them intact daily.

26. An aged trial balance of accounts receivable may provide evidence on the adequacy of the allowance for uncollectible accounts.

27. Analytical procedures are a required as a part of the.  
   A) Overall review at the conclusion of the audit.  
   B) Detailed tests of balances.  
   C) Substantive testing.  
   D) Internal control assessment.

28. Control over the receipt of cash sales is best achieved when two or more employees participate in each transaction.

29. A very material distortion in the financial statements which makes them misleading should result in the issuance of an adverse opinion.

30. Auditors must communicate internal control "reportable conditions" to:  
   B) The audit committee.  
   C) The shareholders.  
   D) The SEC.

31. For effective internal control, the billing function should not be performed by the:  
   A) Accounting department.  
   B) Finance department.  
   C) Data processing departments.  
   D) Sales department.
32. In auditing the balance sheet, most revenue and expense accounts are also audited. Which accounts are most likely to be audited when auditing Accounts Receivable?
A) Interest and Cost of Goods Sold.
B) Sales and Cost of Goods Sold.
C) Interest and Bad Debt Expense.
D) Sales and Bad Debt Expense.

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

34. Which of the following procedures in the cash disbursements cycle should not be performed by the accounts payable department?
A) Preparing the check for signature by an authorized person.
B) Verifying the mathematical accuracy of the vendor's invoice.
C) Comparing the vendor's invoice with the receiving report.
D) Canceling supporting documentation after payment.

35. Which of the following auditing procedures is ordinarily performed last?
A) Confirming accounts payable.
B) Obtaining a management representation letter.
C) Testing of the purchasing function.
D) Reading of the minutes of the directors' meetings.

36. One reason why the independent auditors perform analytical procedures on the client's operations is to identify:
A) Improper separation of accounting and other financial duties.
B) Weaknesses of a material nature in internal control.
C) Unusual transactions.
D) Non-compliance with prescribed control procedures.

37. Confirmation of accounts receivable by direct communication with the debtor tests the existence of accounts receivable.

38. A CPA should maintain objectivity and be free of conflicts of interest when performing:
A) Audits, but not any other professional services.
B) All attestation services, but not other professional services.
C) All attestation and tax services, but not other professional services.
D) All professional services.

39. The American Institute of Certified Public Accountants issues CPA certificates and permits CPAs to practice.

40. The SEC does not pass on the merits of the securities that are registered with the agency.
Questions v1

1. Describe the difference between sampling risk and nonsampling risk?

ANSWER

• Sampling risk is the possibility that the auditors will make an erroneous decision based on a sample result. (7 points)
• Nonsampling risk is the risk of erroneous conclusions by the auditors based on any factor other than sampling. (7 points)

2. Indicate one audit procedure that should be performed by the Independent Auditor in gathering evidence in support of the following items found on the clients reconciliation of their bank account as of December 31, 2003.
   a. Balance per bank
   b. Deposits in transit
   c. Outstanding checks
   d. Balance per books

ANSWER (any 4 at 7 points each = 28 points maximum)

a. Balance per bank
   • Confirm by direct written communication with bank.
   • Obtain and inspect a January 2004 cutoff bank statement received directly from the bank (examine opening balance).

b. Deposit in transit
   • Verify that the deposit was listed in the January 2004 cutoff bank statement on a timely basis.
   • Trace to the cash receipts journal.
   • Inspect the client's copy of the deposit slip for the date of deposit.

c. Outstanding checks
   • Trace to the cash disbursements journal.
   • Examine all supporting documents for those outstanding checks that were not returned with the cutoff bank statement.
   • Examine checks accompanying the January 2004 cutoff bank statement and trace all 2003, or prior, checks to the outstanding check list.

d. Balance per books
   • Foot this total and compare this balance with the general ledger balance.
3. Auditors must be concerned with events that occur subsequent to the balance sheet date, because the events may need to be reflected in the financial statements.
   a. Describe the two general types of subsequent events.
   b. What is the auditors' responsibility with respect to detecting subsequent events?
   c. List three audit procedures that are used by the auditors to search for subsequent events.

**ANSWER**

a. The two types of subsequent events are:

   **Type 1**--events that provide additional evidence about conditions that existed at the balance sheet date and affect the estimates included in the statements. (7 points)

   **Type 2**--events that provide evidence about conditions that arose subsequent to the balance sheet date and require disclosure in the financial statements. (7 points)

b. Auditors have a responsibility to search for material subsequent events to the last day of field work (the date of the auditors' report). (7 points)

c. Procedures that are used to search for subsequent events include (only three required):
   (any 3 at 7 points each = 21 points)
   * Review interim financial statements.
   * Review minutes of directors' and stockholders' meetings.
   * Make inquiries of officers.
   * Obtain a letter from the client's attorney.
   * Obtain a letter of representations from management.
4. Upon completing an audit, the auditors should issue an opinion on the client's financial statements.
   a. List the conditions that permit the issuance of an unqualified opinion on the financial statements.
   b. Describe two situations in which the auditors may modify their standard report and still issue an unqualified opinion.

**ANSWER**

a. The conditions that permit issuance of an unqualified opinion include:

1. The financial statements are presented in conformity with generally accepted accounting principles, including adequate disclosure.  **(7 points each underline = 14 points)**
2. The audit was performed in accordance with generally accepted auditing standards and there were no significant scope limitations preventing the auditors from gathering the evidence necessary to support their opinion.  **(7 points each underline = 14 points)**

b. Modifications of the auditors' report that do not result in qualification include (only two required):  **(any 2 at 7 points each = 14 points)**

* Reliance upon other auditors (shared responsibility audits).
* Emphasis of a matter.
* Departure from an officially recognized accounting principle because application would result in materially misleading financial statements.
* A question about a company's ability to remain a going concern.
* GAAP not consistently applied.
5. Identify FIVE deficiencies (including both incorrect statements and omissions) contained in the auditors' report as drafted below. You will receive credit for those you properly identify, and lose credit for those you identify which aren't actually deficiencies.

Auditors' Report

To the Board of Directors and Management
XYZ Company

We have reviewed the consolidated balance sheet of XYZ Company as of December 31, 20XX, and the related statements of income, retained earnings, and cash flows for the year then ended. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted accounting standards. Those standards require that we plan and perform the audit to obtain absolute assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present the financial position of XYZ Company as of December 31, 20XX, and the results of operations and its cash flows for the year then ended in conformity with auditing standards generally accepted in the United States of America applied on a consistent basis with the preceding year.

Art Youngster & Co.
Certified Public Accountants
Phoenix, Arizona
December 31, 20XX
ANSWER  (any 5 at 7 points each = 35 points)
The report contains the following deficiencies:

1. Introductory paragraph
* In sentence 1, the word "reviewed" should be "audited."
* The sentence on the responsibility of management is omitted.

2. Scope Paragraph
* Sentence 1 should state that the audit was performed in accordance with auditing standards generally accepted in the United States of America.
* Sentence 2 should state that an audit provides "reasonable," not "absolute" assurance.

3. Opinion Paragraph
* "Auditing standards" should be "accounting principles."
* No mention of consistency should be made.

4. Other
* The word "independent" should be included in the report's title.
* The report should be dated as of the last day of field work, not the last day of the year being audited.

6. The following questions relate to the talk given by Mike Corey of PWC on Dec. 1st.
   a. Where did the name Sarbanes-Oxley come from?
   These were the names of the congressmen that authored the bill. (7 points)
   
   b. What is the basic requirement of section 404 as it relates to the auditors?
   Section 404 requires auditors to issue a separate opinion on the Internal Control environment of their client. (7 points)
   
   c. Mike has trained over _________ people on Internal Control over the past six months.
   1000  (7 points)
### Answer Key (3 points each = 120 points)

1. False
2. D
3. C
4. B  MC 120
5. C  1  14
6. True  2  28
7. C  3  42
8. B  4  42
9. D  5  35
10. A  6  21
11. B  Total  302
12. C
13. A
14. C
15. B
16. A
17. D
18. A
19. B
20. B
21. False
22. D
23. C
24. False
25. False
26. True
27. A
28. True
29. True
30. B
31. D
32. D
33. C
34. D
35. B
36. C
37. True
38. D
39. B - False
40. A - True