

Auditing Study Guide

Chapter 1

1-21. These questions pertain to types of audits and other services performed by CPA firms.

1. A governmental audit may extend beyond an audit leading to the expression of an opinion on the fairness of financial presentation to include

	Program Results	Compliance	Economy & Efficiency
a.	Yes	Yes	No
** b.	Yes	Yes	Yes
c.	No	Yes	Yes
d.	Yes	No	Yes

2. Operational audits generally have been conducted by internal auditors and governmental audit agencies, but may be performed by certified public accountants. A primary purpose of an operational audit is to provide

- a. A means of assurance that internal controls are functioning as planned.
- b. Aid to the independent auditor, who is conducting the audit of the financial statements.
- c. The results of internal examinations of financial and accounting matters to a company's top-level management.
- ** d. A measure of management performance in meeting organizational goals.

3. A attestation engagement is one in which a CPA is engaged to

- ** a. Issue a written communication expressing a conclusion about the reliability of a written assertion that is the responsibility of another party.
- b. Provide tax advice or prepare a tax return based on financial information the CPA has **not** audited or reviewed.
- c. Testify as an expert witness in accounting, auditing, or tax matters, given certain stipulated facts.
- d. Assemble prospective financial statements based on the assumptions of the entity's management without expressing any assurance.

1-22. These questions relate to quality control standards.

1. Which of the following are elements of a CPA firm's quality control that should be considered in establishing its quality control policies and procedures?

	Advancement	Inspection	Consultation
a.	Yes	Yes	Yes
** b.	Yes	Yes	Yes
c.	No	Yes	Yes
d.	Yes	No	Yes

2. A CPA firm studies its personnel advancement experience to ascertain whether individuals meeting stated criteria are assigned increased degrees of responsibility. This is evidence of the firm's adherence to prescribed standards of

- a. Supervision and review.
- b. Continuing professional education.
- c. Professional development.
- ** d. Quality control.

3. A CPA firm would be reasonably assured of meeting its responsibility to provide services that conform with professional standards by

- a. Adhering to generally accepted auditing standards.
- ** b. Having an appropriate system of quality control.
- c. Joining professional societies that enforce ethical conduct.
- d. Maintaining an attitude of independence in its engagements.

Chapter 2

2-21. These questions pertain to basic considerations in financial statement audits.

1. One of the following is not a proper condition that supports the need for an independent audit of financial statements.

- ** a. Conflict of interest between management and the CPA.
- b. Complexity of the financial statements.
- c. Remoteness of users from the accounting records.
- d. Consequence of the financial statements in the user's decision process.

2. An independent audit aids in the communication of economic data because the audit

- a. Confirms the accuracy management's financial representations.
- ** b. Lends credibility to the financial statements.
- c. Guarantees that financial data are fairly presented.
- d. Assures the readers of financial statements that any fraudulent activity has been corrected.

3. To emphasize auditor independence from management, many corporations follow the practice of

- a. Appointing a partner of the CPA firm conducting the examination to the corporation's audit committee.
- b. Establishing a policy of discouraging social contact between employees of the corporation and the staff of the independent auditor.
- c. Requesting that a representative of the independent auditor be on hand at the annual stockholder's meeting.
- ** d. Having the independent auditor report to an audit committee of outside members of the board of directors.

2-22. These questions involve AICPA auditing standards.

1. Which of the following statements best describes the phrase "generally accepted auditing standards"?

- a. They identify the policies and procedures for the conduct of the audit.
- b. They define the nature and extent of the auditor's responsibilities.
- c. They provide guidance to the auditor with respect to planning the audit and writing the audit report.
- ** d. They set forth a measure of the quality of the performance of audit procedures.

2. The general group of the generally accepted auditing standards includes a requirement that

- a. The auditor's report state whether or not the financial statements conform to generally accepted accounting principles.
- b. The field work be adequately planned and supervised.
- ** c. Due professional care be exercised by the auditor.
- d. Informative disclosures in the financial statements be reasonably adequate.

3. Auditing standards differ from auditing procedures in that procedures relate to

- a. Measures of performance.
- b. Audit principles.
- ** c. Acts to be performed.
- d. Audit judgments.

2-23. These questions relate to the auditor's report.

1. Which of the following representations does an auditor make explicitly and which implicitly when issuing an unqualified opinion?

- | | Conformity
with GAAP | Adequacy
of Disclosure |
|-------|---------------------------------|-----------------------------------|
| a. | Explicitly | Explicitly |
| b. | Implicitly | Implicitly |
| c. | Implicitly | Explicitly |
| ** d. | Explicitly | Implicitly |

2. When financial statements are presented that are *not* in conformity with generally accepted accounting principles, an auditor may issue a (an)

- | | Qualified
Opinion | Disclaimer
of an Opinion |
|-------|------------------------------|-------------------------------------|
| ** a. | Yes | No |
| b. | Yes | Yes |
| c. | No | Yes |
| d. | No | No |

3. How are management's responsibility and the auditor's responsibility represented in the standard auditor's report?

	Management's Responsibility	Auditor's Responsibility
** a.	Explicitly	Explicitly
b.	Implicitly	Implicitly
c.	Implicitly	Explicitly
d.	Explicitly	Implicitly

4. The existence of audit risk is recognized by the statement in the auditor's standard report that the auditor

- ** a. Obtains reasonable assurance about whether the financial statements are free of material misstatement.
- b. Assesses the accounting principles used and also evaluates the overall financial statement presentation.
- c. Realizes some matters, either individually or in the aggregate, are important while other matters are **not** important.
- d. Is responsible for expressing an opinion on the financial statements, which are the responsibility of the management.

5. The following explanatory paragraph was included in an auditor's report to indicate a lack of consistency:

"As discussed in note T to the financial statements, the company changed its method of computing depreciation in 1990."

How should the auditor report on this matter if the auditor concurred with the change?

	Type of Opinion	Location of Explanatory Paragraph
a.	Unqualified	Before opinion paragraph
** b.	Unqualified	After opinion paragraph
c.	Qualified	Before opinion paragraph
d.	Qualified	After opinion paragraph

2-24. These questions involve the auditor's responsibilities for errors, irregularities, and illegal acts.

1. Which of the following statements concerning illegal acts by clients is correct?

- ** a. An auditor's responsibility to detect illegal acts that have a direct and material effect on the financial statements is the same as that for errors and irregularities.
- b. An audit in accordance with generally accepted auditing standards normally includes audit procedures specifically designed to detect illegal acts that have an indirect but material effect on the financial statements.
- c. An auditor considers illegal acts from the perspective of the reliability of management's representations rather than their relation to audit objectives derived from financial statement assertions.
- d. An auditor has no responsibility to detect illegal acts by clients that have an indirect effect on the financial statements.

2. Under Statements on Auditing Standards, which of the following would be classified as an error?

- a. Misappropriation of assets for the benefit of management.
- ** b. Misinterpretation by management of facts that existed when the financial statements were prepared.
- c. Preparation of records by employees to cover a fraudulent scheme.
- d. Intentional omission of the recording of a transaction to benefit a third party.

3. With respect to errors and irregularities, the auditor should plan to

- a. Detect errors that would have a material effect and irregularities that would have either a material or immaterial effect on the financial statements.
- b. Discover irregularities that would have a material effect and errors that would have either a material or immaterial effect on the financial statements.
- ** c. Detect errors or irregularities that would have a material effect on the financial statements.
- d. Discover errors or irregularities that have either a material or immaterial effect on the financial statements.

4. Which of the following statements describes why a properly designed and executed audit may **not** detect a material irregularity?

- ** a. Audit procedures that are effective for detecting an unintentional misstatement may be ineffective for an intentional misstatement that is concealed through collusion.
- b. An audit is designed to provide reasonable assurance of detecting material errors, but there is **no** similar responsibility concerning material irregularities.
- c. The factors considered in assessing control risk indicated an increased risk of intentional misstatements, but only a low risk of unintentional errors in the financial statements.
- d. The auditor did **not** consider factors influencing audit risk for account balances that have effects pervasive to the financial statements taken as a whole.

Chapter 3

3-21. These questions relate to the nature and purpose of the AICPA Code of Professional Conduct.

1. Which of the following statements best describes why the CPA profession has deemed it essential to promulgate ethical standards and to establish means for ensuring their observance?

- a. A requirement for a profession is the establishment of ethical standards that stress primarily a responsibility to clients and colleagues.
- b. A requirement of most state laws calls for the profession to establish a code of ethics.
- c. An essential means of self-protection for the profession is the establishment of flexible ethical standards by the profession.
- ** d. A distinguishing mark of a profession is its acceptance of responsibility to the public.

2. The AICPA Code of Professional Conduct contains both principles that are aspirational in character and also a

- a. List of violations that would cause the automatic suspension of the CPA's license.
- ** b. Set of specific, mandatory rules describing minimum levels of conduct the CPA must maintain.
- c. Description of the CPA's procedures for responding to an inquiry from a trial board.
- d. List of specific crimes that would be considered as acts discreditable to the profession.

3. Pursuant to the AICPA Code of Professional Conduct, the auditor's responsibility to the profession is defined by

- ** a. The AICPA Code of Professional Conduct.
- b. Federal laws governing licensed professionals who are involved in interstate commerce.
- c. Statements on Auditing Standards.
- d. The Bylaws of the AICPA.

3-22. These questions pertain to the CPA's independence.

1. According to the profession's ethical standards, an auditor would be considered independent in which of the following instances?

- ** a. The auditor's checking account, which is fully insured by a federal agency, is held at a client financial institution.
- b. The auditor is also an attorney who advises the client as its general counsel.
- c. An employee of the auditor donates service as treasurer of a charitable organization that is a client.
- d. The client owes the auditor fees for two consecutive annual audits.

2. A CPA purchased stock in a client corporation and placed it in a trust as an educational fund for the CPA's minor child. The trust securities were not material to the CPA but were material to the child's personal net worth. Would the independence of the CPA be considered impaired with respect to the client?

- ** a. Yes, because the stock would be considered a direct financial interest and, consequentially, materiality is *not* a factor.
- b. Yes, because the stock would be considered an indirect financial interest that is material to the CPA's child.
- c. No, because the CPA would *not* be considered to have a direct financial interest in the client.
- d. No, because the CPA would *not* be considered to have a material indirect financial interest in the client.

3. Which of the following legal situations would be considered to impair the auditor's independence?

- a. An expressed intention by the present management to commence litigation against the auditor alleging deficiencies in audit work for the client, although the auditor considers that there is only a remote possibility that such a claim will be filed.
- b. Actual litigation by the auditor against the client for an amount *not* material to the auditor or to the financial statements of the client arising out of disputes as to billings for management advisory services.
- ** c. Actual litigation by the auditor against the present management alleging management fraud or deceit.
- d. Actual litigation by the client against the auditor for an amount *not* material to the auditor or to the financial statements of the client arising out of disputes as to billings for tax services.

3-23. These questions involve other rules in the Code of Professional Conduct.

1. Without the consent of the client, a CPA should *not* disclose confidential client information contained in working papers to a

- a. Voluntary quality control review board.
- ** b. CPA firm that has purchased the CPA's accounting practice.
- c. Federal court that has issued a valid subpoena.
- d. Disciplinary body created under state statute.

2. The profession's ethical standards would most likely be considered to have been violated when the CPA represents that specific consulting services will be performed for a stated fee and it is apparent at the time of the representation that the

- a. CPA would *not* be independent.
- b. Fee was a competitive bid.
- ** c. Actual fee would be substantially higher.
- d. Actual fee would be substantially lower than the fees charged by other CPA's for comparable services.

3. On completing an audit, Larkin, CPA, was asked by the client to provide technical assistance in the implementation of a new EDP system. The set of pronouncements designed to guide Larkin in this engagement is the Statements on

- a. Auditing Standards.
- ** b. Standards for Management Advisory Services.
- c. Quality Control Standards.
- d. Standards for Accountants' EDP Services.

Chapter 4

4-21. These questions pertain to the auditor's liability under common law.

1. If a stockbroker sues a CPA for common law fraud based on false statements contained in the financial statements audited by the CPA, which of the following is the CPA's best defense?

- a. The CPA did *not* financially benefit from the alleged fraud.
- b. There was contributory negligence of the client.
- c. The stockholder lacks privity to sue.
- ** d. The false statements were immaterial.

2. In a common law action against an accountant, the lack of privity is a viable defense if the plaintiff

- ** a. Is a creditor of the client who sues the accountant for negligence.
- b. Can prove the presence of gross negligence, which amounts to a reckless disregard for the truth.
- c. Is the accountant's client.
- d. Bases his action on fraud.

3. Starr Corp., approved a plan of merger with Silo Corp. One of the determining factors in approving the merger was the strong financial statements of Silo, which were audited by Cox & Co., CPAs. Starr had engaged Cox to audit Silo's financial statements. While performing the audit, Cox failed to discover certain irregularities, which have subsequently caused Starr to suffer substantial losses. For Cox to be liable under common law, Starr at a minimum must prove that Cox

- a. Acted recklessly or with lack of reasonable grounds for belief.
- b. Know of the irregularities.
- ** c. Failed to exercise due care.
- d. Was grossly negligent.

4-22. These questions relate to the auditor's liability under statutory law.

1. One of the elements necessary to recover damages if there has been a material misstatement in a registration statement filed pursuant to the Securities Act of 1933 is that the

- ** a. Plaintiff suffered a loss.
- b. Plaintiff gave value for the security.
- c. Issuer and plaintiff were in privity of contract with each other.
- d. Issuer failed to exercise due care in connection with the sale of the securities.

2. To be successful in a civil action under Section 11 of the Securities Act of 1933 concerning liability for a misleading registrant statement, the plaintiff must prove

	Defendant's Intent to Deceive	Plaintiff's Reliance on the Registration Statement
a.	Yes	Yes
b.	Yes	No
c.	No	Yes
** d.	No	No

3. In which of the following statements concerning a CPA firm's action is scienter or it's equivalent absent?

- a. Actual knowledge of fraud.
- ** b. Performance of substandard auditing procedures.
- c. Reckless disregard for the truth.
- d. Intent to gain monetarily by concealing fraud.

4. Sharp & Co., CPAs, was engaged by Radar Corp. to audit its financial statements. Sharp issued an unqualified opinion on Radar's financial statements. Radar has been accused of making negligent misrepresentations in the financial statements that Wisk relied on when purchasing Radar stock. Sharp was not aware of the misrepresentations nor was it negligent in performing the audit. If Wisk sues Sharp for damages based on Section 10(b) and Rule 10b-5 of the Securities Exchange Act of 1934, Sharp will

- a. Lose because the statements contained negligent misrepresentations.
- b. Lose because Wisk relied on the financial statements.
- ** c. Prevail because some element of scienter must be proved.
- d. Prevail because Wisk was *not* in privity of contract with Sharp.

5. How does the Securities Act of 1933, which imposes civil liability on auditors for misrepresentations or omissions of material facts in a registration, expand auditors' liability to purchasers of securities beyond that of common law?

- a. Purchasers only have to prove loss caused by reliance on audited financial statements.
- ** b. Privity with purchasers is **not** a necessary element of proof.
- c. Purchasers have to prove either fraud or gross negligence as a basis for recovery.
- d. Auditors are held to a standard of care described as "professional skepticism."

Chapter 5

5-21. These questions pertain to financial statement assertions.

1. Inquiries of warehouse personnel concerning possible obsolete or slow-moving inventory items provide assurance about management's assertion of

- a. Completeness.
- b. Existence.
- c. Presentation.
- ** d. Valuation.

2. An auditor most likely would inspect loan agreements under which an entity's inventories are pledged to support management's financial statement assertion of

- a. Existence or occurrence.
- b. Completeness.
- ** c. Presentation and disclosure.
- d. Valuation or allocation.

3. Which of the following procedures would an auditor most likely perform to verify management's assertion of completeness?

- ** a. Compare a sample of shipping documents to related sales invoices.
- b. Observe the client's distribution of payroll checks.
- c. Confirm a sample of recorded receivables by direct communication with the debtors.
- d. Review standard bank confirmations for indications of kiting.

5-22. These questions relate to evidential matter.

1. Two assertions for which confirmation of accounts receivable balances provide primary evidence are

- a. Completeness and valuation.
- b. Valuation and rights and obligations.
- ** c. Rights and obligations and existence.
- d. Existence and completeness.

2. Which of the following statements relating to the competence of evidential matter is always true?

- a. Evidential matter gathered by an auditor from outside an enterprise is reliable.
- b. Accounting data developed under satisfactory internal control are more relevant than data developed under unsatisfactory internal control conditions.
- c. Oral representations made by management are not valid evidence.
- ** d. Evidence gathered by auditors must be both valid and relevant to be considered competent.

3. Audit evidence can come in different forms with different degrees of persuasiveness. Which of the following is the least persuasive type of evidence?

- a. Bank statement obtained from the client.
- b. Computations made by the auditor.
- ** c. Prenumbered client sales invoices.
- d. Vendor's invoice.

4. Which of the following statements is generally correct about the competence of evidential matter?

- ** a. The auditor's direct personal knowledge, obtained through observation and inspection, is more persuasive than information obtained indirectly from independent outside sources.
- b. To be competent, evidential matter must be either valid or relevant, but need *not* be both.
- c. Accounting data alone may be considered sufficient competent evidential matter to issue an unqualified opinion on financial statements.
- d. Competence of evidential matter refers to the amount of corroborative evidence to be obtained.

5-23. These questions pertain to audit procedures.

1. A basic premise underlying analytical review procedures is that

- a. These procedures **cannot** replace tests of balances and transactions.
- b. Statistical tests of financial information may lead to the discovery of material errors in the financial statements.
- c. The study of financial ratios is an acceptable alternative to the investigation of unusual fluctuations.
- ** d. Relationships among data may reasonably be expected to exist and continue in the absence of known conditions to the contrary.

2. Which of the following ultimately determines the specific audit procedures necessary to provide an independent auditor with a reasonable basis for the expression of an opinion?

- a. The audit program.
- ** b. The auditor's judgment.
- c. Generally accepted auditing standards.
- d. The auditor's working papers.

3. In the context of an audit of financial statements, substantive tests are audit procedures that

- a. May be eliminated under certain conditions.
- b. Are designed to discover significant subsequent events.
- ** c. May be either tests of transactions, tests of balances, or analytical tests.
- d. Will increase proportionately with the auditor's detection risk.

5-24. These questions apply to working papers.

1. An auditor's working papers should

- a. Not be permitted to serve as a reference source for the client.
- b. Not contain critical comments concerning management.
- ** c. Show that the accounting records agree or reconcile with the financial statements.
- d. Be considered the primary support for the financial statements being audited.

2. Which of the following statements concerning working papers is incorrect?

- a. An auditor may support an opinion by other means in addition to working papers.
- b. The form of working papers should be designed to meet the circumstances of a particular engagement.
- ** c. An auditor's working papers may **not** serve as a reference source for the client.
- d. Working papers should show that the internal control structure has been studied and evaluated to the degree necessary.

3. The current file of the auditor's working papers generally should include

- a. A flowchart of the internal accounting controls.
- b. Organization charts.
- ** c. A copy of the financial statements.
- d. Copies of bond and note indentures.

4. The audit working paper that reflects the major components of an amount reported in the financial statements is the

- a. Interbank transfer schedule.
- b. Carryforward schedule.
- c. Supporting schedule.
- ** d. Lead schedule.

Chapter 6

6-21. These three questions involve accepting an audit engagement.

1. Before accepting an audit engagement, a successor auditor should make specific inquiries of the predecessor auditor regarding the predecessor's

- a. Awareness of the consistency in the application of GAAP between periods.
- b. Evaluation of all matters of continuing accounting significance.
- c. Opinion of any subsequent events occurring since the predecessor's audit report was issued.
- ** d. Understanding as to the reasons for the change of auditors.

2. A CPA is most likely to refer to one or more of the three general auditing standards in determining

- a. Awareness of the consistency in the application of GAAP between periods.
- b. Evaluation of all matters of continuing accounting significance.
- c. Opinion of any subsequent events occurring since the predecessor's audit report was issued.
- ** d. Whether the CPA should undertake an audit engagement.

3. Engagement letters are widely used in practice for professional engagements of all types. The primary purpose of the engagement letter is to

- a. The nature of the CPA's report qualification.
- b. The scope of the CPA's auditing procedures.
- c. Requirements for the review of the internal control structure.
- ** d. Provide a written record of the agreement with the client as to the services to be provided.

4. The exercise of due professional care requires that an auditor

- a. Examine all available corroborating evidence.
- ** b. Critically review the judgment exercised at every level of supervision.
- c. Reduce control risk below the maximum.
- d. Attain the proper balance of professional experience and formal education.

6-22. These questions relate to planning the engagement.

1. The element of the audit planning process most likely to be agreed on with the client before implementation of the audit strategy is the determination of the

- a. Methods of statistical sampling to be used I confirming accounts receivable.
- b. Pending legal matters to be included in the inquiry of the client's attorney.
- c. Evidence to be gathered to provide a sufficient basis for the auditor's opinion.
- ** d. Schedules and analyses to be prepared by the client's staff.

2. An abnormal fluctuation in gross profit that might suggest the need for extended audit procedures for sales and inventories would most likely be identified in the planning phase of the audit by the use of

- a. A review of prior years' working papers.
- b. An evaluation of the entity's internal control structure.
- c. Specialized audit programs.
- ** d. Analytical procedures.

3. Analytical procedures used in planning an audit should focus on identifying

- a. Material weakness in the internal control structure.
- b. The predictability of financial data from individual transactions.
- c. The various assertions that are embodied in the financial statements.
- ** d. Areas that may represent specific risks relevant to the audit.

4. For all audits of financial statements made in accordance with GAAS, the use of analytical procedures is required to some extent

	In the Planning Stage	As a Substantive Test	In the Review Stage
** a.	Yes	No	Yes
b.	No	Yes	No
c.	No	Yes	Yes
d.	Yes	No	No

Chapter 7

7-21. The following questions pertain to materiality.

1. Which of the following underlies the application of GAAS, particularly the standards of field work and reporting?

- a. Internal control structure.
- b. Corroborating evidence.
- ** c. Materiality and relative risk.
- d. Reasonable assurance.

2. Which one of the following statements is correct concerning the concept of materiality?

- a. Materiality is determined by reference to guidelines established by the AICPA.
- b. Materiality depends only on the dollar amount of an item relative to other items in the financial statements.
- c. Materiality depends on the nature of an item rather than the dollar amount.
- ** d. Materiality is a matter of professional judgment.

3. The concept of materiality would be least important to an auditor in determining the

- a. Transactions that should be reviewed.
- b. Need for disclosure of a particular fact or transaction.
- c. Scope of the CPA's audit program relating to various accounts.
- ** d. Effects of direct financial interest in the client upon the CPA's independence.

7-22. These questions pertain to audit risk and its components.

1. In planning an audit, the auditor considers audit risk, which is the
 - a. Susceptibility of an account balance to material error assuming the client does not have any related internal controls.
 - b. Risk that a material error in an account will not be prevented or detected on a timely basis by the client's internal control structure.
 - c. Risk that the auditor's procedures for verifying account balances will not detect a material error when in fact such error exists.
 - ** d. Risk that the auditor may unknowingly fail to appropriately modify the opinion on financial statements that are materially misstated.

2. The risk that an auditor's procedures will lead to the conclusion that a material misstatement does not exist in an assertion when, in fact, such misstatement does exist is referred to as

- a. Audit risk.
- b. Inherent risk.
- c. Control risk.
- ** d. Detection risk.

3. Which of the following audit risk components may be assessed in non-quantitative terms?

	<u>Inherent Risk</u>	<u>Control Risk</u>	<u>Detection Risk</u>
a.	Yes	Yes	No
b.	Yes	No	Yes
c.	No	Yes	Yes
** d.	Yes	Yes	Yes

7-23. The following questions deal with the preliminary audit strategies (these questions were written by the auditors).

1. Which of the following best describes the nature of a preliminary audit strategy.
 - a. It is a detailed specification of auditing procedures to be performed.
 - b. It represents the auditor's plan for meeting the general standards of GAAS.
 - ** c. It represents the auditor's preliminary judgments about an audit approach and reflects certain assumptions about the conduct of the audit.
 - d. It is the auditor's plan for meeting the second standard of field work.

2. In developing a preliminary audit strategy, the auditor specifies each of the following components except

- a. The extent of understanding of the internal control structure to be obtained.
- ** b. The tests of details of transactions and balances to be performed.
- c. The planned assessed level of control risk.
- d. The extent of tests of controls to be performed.

3. Use of the lower assessed level of control risk approach is least likely when

- a. The auditor expects that controls related to an assertion are well designed and highly effective.
- b. An assertion is affected by high volume of routine transactions that are subject to processing controls.
- ** c. The account to which an assertion pertains is affected primarily by infrequent transactions or adjusting entries.
- d. The cost of performing more extensive procedures to obtain the understanding of the internal control structure and test controls will be more than offset by cost savings from performing less extensive substantive tests.

Chapter 8

1. Which of the following is not a component of an entity's internal control structure?

- ** a. Audit risk.
- b. Control activities.
- c. Information and communication.
- d. Control environment.

2. Which of the following components of an entity's internal control structure includes the development of employee promotion and training policies?

- a. Control activities.
- ** b. Control environment.
- c. Information and communication.
- d. Quality control system.

3. An auditor's primary consideration regarding an entity's internal control structure policies and procedures is whether they

- a. Prevent management override.
- b. Relate to the control environment.
- c. Reflect management's philosophy and operating style.
- ** d. Affect the financial statement assertions.

4. Which of the following is not a reason an auditor should obtain an understanding of the components of an entity's internal control structure in planning an audit?

- a. To identify the types of potential misstatements that can occur.
- b. To design substantive tests.
- ** c. To consider the operating effectiveness of the internal control structure.
- d. To consider factors that affect the risk of material misstatements.

8-22. These questions pertain to obtaining an understanding of the internal control structure.

1. The primary objective of procedures performed to obtain an understanding of the internal control structure is to provide an auditor with

- a. Evidential matter to use in reducing detection risk.
- ** b. Knowledge necessary to plan the audit.
- c. A basis from which to modify tests of controls.
- d. Information necessary to prepare flowcharts.

2. During consideration of the internal control structure in a financial statement audit, an auditor is **not** obligated to

- ** a. Search for significant deficiencies in the operation of the internal control structure.
- b. Understand the internal control environment and the accounting system.
- c. Determine whether the control procedures relevant to audit planning have been placed in operation.
- d. Perform procedures to understand the design of the internal control structure policies.

3. When obtaining an understanding on an entity's internal control environment, an auditor should concentrate on the substance of management's policies and procedures rather than their form because

- a. The auditor may believe that the policies and procedures are inappropriate for that particular entity.
- b. The board of directors may **not** be aware of management's attitude toward the control environment.
- c. Management may establish appropriate policies and procedures but **not** act on them.
- d. The policies and procedures may be so weak that **no** reliance is contemplated by the auditor.

8-23. These questions involve documenting the auditor's understanding of the internal control structure.

1. An auditor's flowchart of a client's accounting system is a diagrammatic representation that depicts the auditor's

- a. Program for tests of controls.
- ** b. Understanding of the system.
- c. Understanding of the types of irregularities that are probable, given the present system.
- d. Documentation of the study and evaluation of the system.

2. The auditor's understanding of the internal control structure is documented to substantiate

- a. Conformity of the accounting records with GAAP.
- ** b. Compliance with GAAS.
- c. Adherence to requirements of management.
- d. The fairness of the financial statement presentation.

3. Which of the following statements regarding auditor documentation of the client's internal control structure is correct?

- a. Documentation must include flowcharts.
- b. Documentation must include procedural write-ups.
- c. No documentation is necessary, although it is desirable.
- ** d. No one particular form of documentation is necessary, and the extent of documentation may vary.

Chapter 9

9-21. These questions pertain to assessing control risk.

1. After obtaining an understanding of the internal control structure and assessing control risk, an auditor decided not to perform additional tests of control. The auditor most likely concluded that the

- ** a. Additional evidence to support a further reduction in control risk was *not* cost-beneficial to obtain.
- b. Assessed level of inherent risk exceeded the assessed level of control risk.
- c. Internal control structure was properly designed and justifiably may be relied on.
- d. Evidence obtainable through tests of controls would *not* support an increased level of control risk.

2. When an auditor increases the assessed level of control risk because certain control procedures were determined to be ineffective, the auditor would most likely increase the

- a. Extent of tests of controls.
- b. Planned level of detection risk.
- ** c. Planned level of substantive tests.
- d. Level of inherent risk.

3. Which of the following is not a step in an auditor's decision to assess control risk at below the maximum?

- a. Evaluate the effectiveness of the internal control procedures with tests of controls.
- b. Obtain an understanding of the entity's accounting system and control environment.
- ** c. Perform tests of details of transactions to detect material misstatements in the financial statements.
- d. Consider whether control procedures can have a pervasive effect on financial statement assertions.

4. The ultimate purpose of assessing control risk is to contribute to the auditor's evaluation of the risk that

- a. Specified controls requiring segregation of duties may be circumvented by collusion.
- b. Entity policies may be overridden by senior management.
- c. Tests of controls may fail to identify procedures relevant to assertions.
- ** d. Material misstatements may exist in the financial statements.

9-22. These questions relate to tests of control.

1. A procedure that would most likely be used by an auditor in performing tests of control procedures that involve segregation of functions and that leave no transaction trail is

- a. Inspection
- ** b. Observation.
- c. Reperformance.
- d. Reconciliation.

2. To obtain evidential matter about control risk, an auditor ordinarily selects tests from a variety of techniques, including

- a. Analysis.
- b. Confirmation.
- ** c. Reperformance.
- d. Comparison.

3. The objective of tests of details of transactions performed as tests of controls is to

- a. Detect material misstatements in the account balances of the financial statements.
- ** b. Evaluate whether an internal control structure policy or procedure operated effectively.
- c. Determine the nature, timing, and extent of substantive tests for financial statement assertion.
- d. Reduce control risk, inherent risk, and detection risk to an acceptably low level.

4. An auditor wishes to perform tests of controls on a client's cash disbursements procedures. If the control procedures leave no audit trail of documentary evidence, the auditor most likely will test the procedures by

- a. Confirmation and observation.
- ** b. Observation and inquiry.
- c. Analytical procedures and confirmation.
- d. Inquiry and analytical procedures.

9-23. These following questions relate to documenting control risk assessments.

1. When control risk is assessed at the maximum level for all financial statement assertions, an auditor should document the auditor's

	Understanding of the entity's internal control structure components	Conclusion that control risk is at the maximum level	Basis for concluding that control risk is at the maximum level
a.	Yes	No	No
** b.	Yes	Yes	No
c.	No	Yes	Yes
d.	Yes	Yes	Yes

2. When an auditor assesses control risk below the maximum level, the auditor is required to document the auditor's

	Basis for Concluding that control risk is at the maximum level	Understanding of the entity's internal control structure components
a.	No	No
** b.	Yes	Yes
c.	Yes	No
d.	No	Yes

Chapter 10

10-21. These questions relate to detection.

1. The risk that an auditor's procedures will lead to the conclusion that a material misstatement does not exist in an account balance when, in fact, such misstatement does exist is referred to as

- a. Audit risk.
- b. Inherent risk.
- c. Control risk.
- ** d. Detection risk.

2. As the acceptable level of detection risk decreases, the assurance directly provided from

- ** a. Substantive tests should increase.
- b. Substantive tests should decrease.
- c. Tests of controls should increase.
- d. Tests of controls should decrease.

3. An auditor assesses control risk because it

- a. Indicates where inherent risk may be the greatest.
- ** b. Affects the level of detection risk the auditor may accept.
- c. Determines whether sampling risk is sufficiently low.
- d. Includes the aspects of nonsampling risk that are controllable.

10-22. These questions relate to the nature, timing, and extent of substantive tests.

1. As the acceptable level of detection risk decreases, an auditor may change the

- a. Timing of substantive tests by performing them at an interim date rather than at year end.
- ** b. Nature of substantive tests from a less effective to a more effective procedure.
- c. Timing of tests of controls by performing them at several dates rather than at one time.
- d. Assessed level of inherent risk to a higher amount.

2. Before applying principal substantive tests to the details of asset and liability accounts at an interim date, the auditor should

- ** a. Assess the difficulty in controlling incremental audit risk.
- b. Investigate significant fluctuations that have occurred in the asset and liability accounts since the previous balance sheet date.
- c. Select only those accounts that can effectively be sampled during year-end audit work.
- d. Consider the tests of controls that must be applied at the balance sheet date to extend the audit conclusions reached at an interim date.

3. An auditor uses the knowledge provided by the understanding of the internal control structure and the final assessed level of control risk primarily to determine the nature, timing, and extent of the

- a. Attribute tests.
- b. Concurrent tests of controls.
- c. Additional tests of controls.
- ** d. Substantive tests

4. An auditor's decision to either apply analytical procedures as substantive tests or to perform tests of transactions and account balances usually is determined by the

- a. Availability of data aggregated at a high level.
- ** b. Relative effectiveness and efficiency of the tests.
- c. Timing of tests performed after the balance sheet date.
- d. Auditor's familiarity with industry trends.

5. Auditors try to identify predictable relationships when using analytical procedures. Relationships involving transactions from which of the following accounts most likely would yield the highest level of evidence?

- a. Accounts receivable.
- ** b. Interest expense.
- c. Accounts payable.
- d. Travel and entertainment expense.

10-23. These questions apply to special considerations in designing substantive tests and audit programs.

1. After identifying related party transactions, an auditor most likely would

- a. Substantiate that the transactions were consummated on terms equivalent to those prevailing in arms-length transactions.
- b. Discuss the implications of the transactions with third parties, such as the entity's attorneys and bankers.
- ** c. Determine whether the transactions were approved by the board of directors or other appropriate officials.
- d. Ascertain whether the transactions would have occurred if the parties had not been related.

2. In designing written audit programs, an auditor should establish specific audit objectives that relate primarily to the

- a. Timing of audit procedures.
- b. Cost-benefit of gathering evidence.
- c. Selected audit techniques.
- ** d. Financial statement assertions.

3. The procedures specifically outlined in an audit program are primarily designed to

- a. Protect the auditor in the event of litigation.
- b. Detect errors or irregularities.
- c. Test internal control structures.
- ** d. Gather evidence.

4. Which of the following is required documentation in an audit in accordance with generally accepted auditing standards?

- a. A flowchart or narrative of the accounting system describing the recording and classification of transactions for financial reporting.
- ** b. An audit program setting forth in detail the procedures necessary to accomplish the engagement's objectives.
- c. A planning memorandum establishing the timing of the audit procedures and coordinating the assistance of entity personnel.
- d. An internal control questionnaire identifying policies and procedures that assure specific objectives will be achieved.

5. In evaluating an entity's accounting estimates, one of an auditor's objectives is to determine whether the estimates are

- a. Not subject to bias.
- b. Consistent with industry guidelines.
- c. Based on objective assumptions.
- ** d. Reasonable in the circumstances.

Chapter 11

11-21. These questions pertain to the use of sampling in auditing.

1. An advantage to using statistical over non-statistical sampling methods in tests of controls is that the statistical methods

- a. Afford greater assurance than a non-statistical sample of equal size.
- ** b. Provide an objective basis for quantitatively evaluating sampling risk.
- c. Can more easily convert the sample into a dual purpose test useful for substantive testing.
- d. Eliminate the need to use judgment in determining appropriate sample size.

2. The risk of incorrect acceptance and the likelihood of assessing control risk too low relate to the

- ** a. Effectiveness of the audit.
- b. Efficiency of the audit.
- c. Preliminary estimates of material levels.
- d. Allowable risk of tolerable error.

3. If fraud or gross error is suspected in the population, the auditor would most likely use

- a. Variables sampling.
- b. Attribute sampling.
- ** c. Discovery sampling.
- d. Dollar-unit sampling.

4. The diagram below depicts the auditor's estimated maximum deviation rate compared with the tolerable rate, and also depicts the true population deviation rate compared with the tolerable rate.

<u>Auditor's estimate based on sample results</u> Maximum deviation rate is less than tolerable rate	<u>True state of population</u>	
	Deviation rate is less than tolerable rate	Deviation rate exceeds tolerable rate
Maximum deviation rate is less than tolerable rate	I	III
Maximum deviation rate exceeds tolerable rate	II	IV

As a result of tests of controls, the auditor assesses control risk higher than necessary and thereby increases substantive testing. This is illustrated by situation

- a. I.
- ** b. II.
- c. III.
- d. IV.

11-22. These questions pertain to determining sample size in an attribute sampling plan.

1. To determine the sample size for a test of controls, an auditor should consider the tolerable deviation rate, the allowable risk of assessing control risk too low, and the

- ** a. Expected deviation rate.
- b. Upper precision limit.
- c. Risk of incorrect acceptance.
- d. Risk of incorrect rejection.

2. Which of the following combinations results in a decrease in sample size in a sample for attributes?

	Risk of Assessing Control Risk Too Low	Tolerable Rate	Expected Population Deviation Rate
a.	Increase	Decrease	Increase
b.	Decrease	Increase	Decrease
** c.	Increase	Increase	Decrease
d.	Increase	Increase	Increase

3. Which of the following statements is correct concerning statistical sampling in tests of controls?

- ** a. The population size has little or *no* effect on determining sample size except for very small populations.
- b. The expected population deviation rate has little or *no* effect on determining sample size except for very small populations.
- c. As the population size doubles, the sample size should also double.
- d. For a given tolerable rate, a larger sample size should be selected as the expected population deviation rate decreases.

4. In planning a statistical sample for a test of controls, an auditor increased the expected population deviation rate from the prior year's rate because of the results of the prior year's tests of controls and the overall control environment. If other factors remain constant, compared to last year this will cause an increase in

- a. Tolerable rate.
- b. Allowance for sampling risk.
- c. Risk of assessing control risk too low.
- ** d. Sample size.

11-23. These questions pertain to the selection of items for a statistical sample.

1. An underlying feature of random-based selection of items is that each

- a. Stratum of the accounting population be given equal representation in the sample.
- b. Item in the accounting population be randomly ordered.
- ** c. Item in the accounting population should have an opportunity to be selected.
- d. Item must be systematically selected using replacement.

2. When performing tests of controls over cash disbursements, a CPA may use a systematic sampling technique with a start at any randomly selected item. The biggest disadvantage of this type of sampling is that the items in the population

- a. Must be recorded in a systematic pattern before the sample can be drawn.
- ** b. May occur in a systematic pattern, thus destroying the sample randomness.
- c. May systematically occur more than once in the sample.
- d. Must be systematically replaced in the population after sampling.

3. An auditor plans to examine a sample of 20 checks for countersignatures as prescribed by the client's internal control procedures. One of the checks in the chosen sample of 20 cannot be found. The auditor should consider the reasons for this limitation and

- a. Evaluate the results as if the sample size had been 19.
- ** b. Treat the missing check as a deviation for the purpose of evaluating the sample.
- c. Treat the missing check in the same manner as the majority of the other 19 checks, that is, countersigned or not.
- d. Choose another check to replace the missing check in the sample.

11-24. These questions pertain to evaluating the results of an attribute sampling plan.

1. In the audit of the financial statements of Delta Company, the auditor determines that in performing a test of controls, the deviation rate in the sample does not support the planned control risk when, in fact, the true deviation rate for the population does not support the planned control risk. This situation illustrates the risk of

- ** a. Assessing control risk too high.
- b. Assessing control risk too low.
- c. Incorrect rejection.
- d. Incorrect acceptance.

Items 2 and 3 are based on the following:

An auditor desired to test credit approval on 10,000 sales invoices processed during the year. The auditor designed a statistical sample that would provide 1% risk of assessing control risk too low (99% confidence) that not more than 7% of the sales invoices lacked approval. The auditor estimated from previous experience that about 2.5% of the sales invoices lacked approval. A sample of 2,000 invoices was examined and 7 of them were lacking approval. The auditor then determined the achieved upper precision limit to be 8%.

2. In the evaluation of this sample, the auditor decided to increase the level of the preliminary assessment of control risk because the

- ** a. Tolerable deviation rate (7%) was less than the achieved upper precision limit (8%).
- b. Expected deviation rate (7%) was more than the percentage of errors in the sample (3.5%).
- c. Achieved upper precision limit (8%) was more than the percentage of errors in the sample (3.5%).
- d. Expected deviation rate (2.5%) was less than the tolerable rate (7%).

3. The allowance for sampling risk was

- a. 5.5%
- ** b. 4.5%
- c. 3.5%
- d. 1%

4. What is an auditor's evaluation of a statistical sample for attributes when a test of 50 documents results in 3 deviations if the tolerable rate is 7%, the expected population deviation rate is 5%, and the allowance for sampling risk is 2%.

- a. Modify the planned assessed level of control risk because the tolerable rate plus the allowance for sampling risk exceeds the expected population deviation rate.
- b. Accept the sample results as support for the planned assessed level of control risk because the sample deviation rate plus the allowance for sampling risk exceeds the tolerable rate.
- c. Accept the sample results as support for the planned assessed level of control risk because the tolerable rate less the allowance for sampling risk equals the expected population deviation rate.
- ** d. Modify the planned assessed level of control risk because the sample deviation rate plus the allowance for sampling risk exceeds the tolerable rate.

Chapter 12

12-21. The following questions relate to a variety of issues concerning audit sampling in substantive testing.

1. An auditor may use either of two statistical sampling approaches in substantive testing, probability-proportional-to-size (PPS) sampling and classical variables sampling, PPS sampling is primarily applicable in testing for

- a. The number of errors in year-end sales cutoff.
- ** b. An overstatement of accounts receivable.
- c. An understatement of accounts payable.
- d. Proper segregation of duties in accounts receivable collections.

2. Which if the following would be designed to estimate a numerical measurement of a population, such as a dollar value?

- ** a. Sampling for variables.
- b. Sampling for attributes.
- c. Discovery sampling.
- d. Numerical sampling.

3. In a probability-proportional-to-size sample with a sampling interval of \$10,000, an auditor discovered that a selected account receivable with a recorded amount of \$5,000 had an audit amount of \$2,000. The projected error of this sample was

- a. \$3,000
- b. \$4,000
- ** c. \$6,000
- d. \$8,000

4. What is the primary objective of using stratification as a sampling method in auditing?

- a. To increase the risk of incorrect acceptance at which a decision will be reached from the results of the sample selected.
- b. To determine the deviation rate for a given characteristic in the population being studied.
- ** c. To decrease the effect of variance in the total population.
- d. To determine the precision interval of the sample selected.

5. Which of the following most likely would be an advantage in using classical variables sampling rather than probability-proportional-to-size (PPS) sampling?

- a. An estimate of the standard deviation of the population's recorded amounts is not required.
- b. The auditor rarely needs the assistance of a computer program to design an efficient sample.
- ** c. Inclusion of zero and negative balances generally does not require special design considerations.
- d. Any amount that is individually significant is automatically identified and selected.

12-22. The following questions relate to the relationship between risk and audit sampling.

1. While performing a substantive test of details during an audit, the auditor determined that the sample results supported the conclusion that the recorded account balance was materially misstated. It was, in fact, not materially misstated. This situation illustrates

- ** a. Incorrect rejection.
- b. Incorrect acceptance.
- c. Assessing control risk too low.
- d. Assessing control risk too high.

2. If the achieved allowance for sampling risk of a statistical sample at a given risk level is greater than the desired allowance, this is an indication that the

- ** a. Standard deviation was larger than expected.
- b. Standard deviation was smaller than expected.
- c. Population was larger than expected.
- d. Population was smaller than expected.

3. An advantage of using statistical sampling techniques is that such techniques

- ** a. Mathematically measure risk.
- b. Eliminate the need for judgmental decisions.
- c. Define the values of tolerable error and risk incorrect acceptance required to provide audit satisfaction.
- d. Have established in the courts to be superior to judgment sampling.

4. The risk that an audit will conclude, based on substantive tests, that a material error does not exist in an account balance when, in fact, such error does exist is referred to as

- ** a. Sampling risk.
- b. Detection risk.
- c. Nonsampling risk.
- d. Inherent risk.

5. An auditor may decide to increase the risk of incorrect rejection when

- a. Increased reliability from the sample is desired.
- b. Many differences (audit value minus recorded value) are expected.
- c. Initial sample results do not support the planned level of control risk.
- ** d. The cost and effort of selecting additional sample items are low.

12-23. The following questions relate to the difference and ratio estimation techniques of variables sampling.

1. An auditor is performing substantive tests of pricing and extensions of perpetual inventory balances consisting of a large number of items. Past experience indicated numerous pricing and extension errors. Which of the following statistical sampling approaches is most appropriate?

- a. Unstratified mean-per-unit.
- b. Probability-proportional-to-size.
- c. Stop or go.
- ** d. Ratio estimation.

2. The major reason that the difference and ratio estimation methods would be expected to produce audit efficiency is that the

- a. Number of members of the population of differences of ratios is smaller than the number of members of the population of book values.
- ** b. Beta risk may be completely ignored.
- c. Calculations required in using difference or ratio estimation are less arduous and fewer than those required when using MPU estimation.
- d. Variability of the populations of differences or ratios is less than that of the populations of book values or audit values.

3. Using statistical sampling to assist in verifying the year-end accounts payable balance, an auditor has accumulated the following data:

	Number of Accounts	Book Balance	Balance Determined by the Auditor
Population	4,100	\$5,000,000	?
Sample	200	\$ 250,000	\$300,000

With the ratio estimation technique, the auditor's estimate of the year-end accounts payable balance would be

- a. \$6,150,000
- ** b. \$6,000,000
- c. \$5,125,000
- d. \$5,050,000

Chapter 13

13-21. These questions pertain to the ICS in an EDP system.

1. Internal control is ineffective when computer department personnel

- a. Participate in computer software acquisition decisions.
- b. Design documentation for computerized systems.
- ** c. Originate changes in master files.
- d. Provide physical security for program files.

2. Which of the following computer documentation would an auditor most likely utilize in obtaining an understanding of the ICS?

- ** a. Systems flowcharts.
- b. Record counts.
- c. Program listings.
- d. Record layouts.

3. Which of the following most likely constitutes a weakness in the ICS of an EDP system?

- a. The control clerk established control over data received by the EDP department and reconciles control totals after processing.
- b. The application programmer identifies programs required by the systems design and flowcharts the logic of these programs.
- ** c. The systems analyst reviews output and controls the distribution of output from the EDP department.
- d. The accounts payable clerk prepares data for computer processing and enters the data into the computer.

4. One of the steps in assessing control risk in an EDP control system is identifying necessary controls to prevent data from being lost, added, duplicated, or altered during processing. An example of this type of control is the

- a. Authorization and approval of the data in user departments and screening of data by data control groups.
- b. Review of data output by data control groups.
- c. Use of external and internal file labels.
- ** d. Use of control totals, limit and reasonableness checks, and sequence tests.

5. Which of the following is *not* a major reason why an accounting audit trail should be maintained for a computer system?

- a. Query answering.
- b. Deterrent to irregularities.
- c. Monitoring purposes.
- ** d. Analytical procedures.

13-22. These questions relate to tests of EDP controls.

1. Which of the following computer-assisted auditing techniques follow fictitious and real transactions to be processed together without client operating personnel being aware of the testing process?

- a. Parallel simulation.
- b. Generalized audit software programming.
- ** c. Integrated test facility.
- d. Test data approach.

2. An auditor may decide not to perform tests of controls related to the control procedures within the EDP portion of the client's ICS. Which of the following would *not* be a valid reason for choosing to omit tests of controls?

- a. The controls duplicate operative controls existing elsewhere in the structure.
- b. There appear to be major weaknesses that would preclude the control from preventing errors and irregularities.
- c. The time and dollar costs of testing exceed the time and dollar savings in substantive testing if the tests show the controls to be effective.
- ** d. The controls appear adequate.

3. When an auditor tests a computerized accounting system, which of the following is true of the test data approach?

- a. Test data must consist of all possible valid and invalid conditions.
- b. The program tested is different from the program used throughout the year by the client.
- c. Several transactions of each type must be tested.
- ** d. Test data are processed by the client's computer programs under the auditor's control.

4. A primary advantage of using generalized audit software packages to audit the financial statements of a client that uses an EDP system is that the auditor may

- a. Consider increasing the use of substantive tests of transactions in place of analytical procedures.
- b. Substantiate the accuracy of data through self-checking digits and hash totals.
- c. Reduce the level of required tests of controls to a relatively small amount.
- ** d. Access information stored on computer files while having a limited understanding of the client's hardware and software features.

Chapter 14

14-21. These questions apply to internal control over credit sales and sales adjustment transactions.

1. Which of the following controls most likely would be effective in offsetting the tendency of sales personnel to maximize sales volume at the expense of high bad debt write-offs?

- a. Employees responsible for authorizing sales and bad debt write-offs are denied access to cash.
- b. Shipping documents and sales invoices are matched by an employee who does not have authority to write off bad debts.
- ** c. Employees involved in the credit-granting function are separated from the sales function.
- d. Subsidiary accounts receivable records are reconciled to the control account by an employee independent of the authorization of credit.

2. Which of the following controls most likely would help ensure that all credit sales transactions of an entity are recorded?

- a. The billing department supervisor sends copies of approved sales orders to the credit department for comparison to authorized credit limits and current customer account balances.
- b. The accounting department supervisor independently reconciles the accounts receivable subsidiary ledger to the accounts receivable control account monthly.
- c. The accounting department supervisor controls the mailing of monthly statements to customers and investigates any differences reported by customers.
- ** d. The billing department supervisor matches pre-numbered shipping documents with entries in the sales journal.

3. Which of the following internal control procedures most likely would assure that all billed sales are correctly posted to the accounts receivable ledger?

- ** a. Daily sales summaries are compared to daily postings to the accounts receivable ledger.
- b. Each sales invoice is supported by a prenumbered shipping document.
- c. The accounts receivable ledger is reconciled daily to the control account in the general ledger.
- d. Each shipment on credit is supported by a prenumbered sales invoice.

4. An auditor most likely would review an entity's periodic accounting for the numerical sequence of shipping documents and invoices to support management's financial statement assertion of

- a. Existence or occurrence.
- b. Rights and obligations.
- c. Valuation and allocation.
- ** d. Completeness.

5. Sound internal control procedures dictate that defective merchandise returned by customers should be presented initially to the

- a. Accounts receivable supervisor.
- ** b. Receiving clerk.
- c. Shipping department supervisor.
- d. Sales clerk.

14-22. These questions pertain to internal control over cash receipts transactions.

1. An auditor would consider a cashier's job description to contain compatible duties of the cashier receives remittances from the mailroom and also prepares the

- a. Prelist of individual checks.
- b. Monthly bank reconciliation.
- ** c. Daily deposit slip.
- d. Remittance advices.

2. The questions below appear on an Internal Control Questionnaire. Which question, in answered NO, would have disclosed that the cashier diverted cash received over the counter from a customer to his or her own use and wrote off receivable as a bad debt?

- a. Are aging schedules of accounts receivable prepared periodically and reviewed by a responsible official?
- ** b. Are journal entries approved by a reasonable official?
- c. Are receipts given directly to the cashier by the person who opens the mail?
- d. Are remittance advices, letters, or envelopes that accompany receipts separated and given directly to the accounting department?

3. In updating a computerized accounts receivable file, which one of the following would be used as a batch control to verify the accuracy of posting cash remittances?

- a. The sum of net sales.
- b. The sum of cash deposits less discounts taken by customers.
- ** c. The sum of cash deposits plus discounts taken by customers.
- d. The sum of net sales plus discounts taken by customers.

4. An entity with a large volume of customer remittances by mail could most likely reduce the risk of employee misappropriation of cash by using

- a. Employee fidelity bonds.
- b. Independently prepared mailroom prelists.
- c. Daily check summaries.
- ** d. A bank lockbox system.

5. Immediately upon receipt of cash, a responsible employee should

- a. Record the amount in the cash receipts journal.
- ** b. Prepare a remittance listing.
- c. Update the subsidiary accounts receivable records.
- d. Prepare a deposit slip in triplicate.

14-23. These questions relate to substantive tests of accounts receivable.

1. An auditor's purpose in reviewing credit ratings of customers with delinquent accounts receivable most likely to obtain evidence concerning management's assertions about

- a. Presentation and disclosure.
- b. Existence or occurrence.
- c. Rights and obligations.
- ** d. Valuation or allocation.

2. The negative request form of accounts receivable confirmation is useful particularly when the

	Assessed Level of Control Risk Relating to Receivables is	Number of Small Balances is	Consideration by the Recipient is
a.	Low	Many	Likely
b.	Low	Few	Unlikely
c.	High	Few	Likely
d.	High	Many	Likely

3. Which of the following most likely would be detected by an auditor's review of a client's sales cutoff?

- ** a. Unrecorded sales for the year.
- b. Lapping of year-end accounts receivable.
- c. Excessive sales discounts.
- d. Unauthorized goods returned for credit.

4. Which of the following most likely would give the most assurance concerning the valuation assertion of accounts receivable?

- a. Tracing amounts in the subsidiary ledger to details on shipping documents.
- b. Comparing receivable turnover ratios to industry statistics for reasonableness.
- c. Inquiring about receivables pledged under loan agreements.
- ** d. Assessing the allowance for uncollectible accounts for reasonableness.

5. Cutoff tests designed to detect credit sales made before the end of the year that have been recorded in the subsequent year provide assurance about management's assertion of

- a. Presentation.
- ** b. Completeness.
- c. Rights.
- d. Existence.

Chapter 15

15-21. These questions pertain to internal control over purchases transactions.

1. When goods are received, the receiving clerk should match the goods with the

- a. Purchase order and the requisition form.
- b. Vendor's invoice and the receiving report.
- ** c. Vendor's shipping document and the purchase order.
- d. Receiving report and the vendor's shipping document.

2. An auditor performs a test to determine whether all merchandise for which the client was billed was received. The population for this test consists of all

- a. Merchandise received.
- ** b. Vendor's invoices.
- c. Cancelled checks.
- d. Receiving reports.

3. Internal control is strengthened when the quantity of merchandise ordered is omitted from the copy of the purchase order sent to the

- a. Department that initiated the requisition.
- ** b. Receiving department.
- c. Purchasing agent.
- d. Accounts payable department.

4. Which of the following controls would be most effective in assuring that recorded purchases are free of material misstatements?

- a. The receiving department compares the quantity ordered on purchase orders with the quantity received on receiving reports.
- b. Vendor's invoices are compared with purchase orders by an employee who is independent of the receiving department.
- c. Receiving reports require the signature of the individual who authorized the purchase.
- ** d. Purchase orders, receiving reports, and vendors' invoices are independently matched in preparing vouchers.

15-22. These questions relate to internal controls and tests of controls for cash disbursements transactions.

1. Which of the following control procedures is not usually performed in the vouchers payable department?

- a. Determining the mathematical accuracy of the vendor's invoice.
- b. Having an authorized person approve the voucher.
- ** c. Controlling the mailing of the check and remittance advice.
- d. Matching the receiving report with the purchase order.

2. In performing tests of controls over authorization of cash disbursements, which of the following sampling methods would be most appropriate?

- a. Ratio.
- ** b. Attributes.
- c. Variables.
- d. Stratified.

3. An auditor wishes to perform tests of controls on a client's cash disbursements procedures. If the control procedures leave no audit trail of documentary evidence, the auditor most likely will test the procedures by

- a. Inquiry and analytical procedures.
- b. Confirmation and observation.
- ** c. Observation and inquiry.
- d. Analytical procedures and confirmation.

15-23. These questions apply to substantive tests of expenditure cycle balances.

1. Which of the following auditing procedures is best for identifying unrecorded trade accounts payable?

- a. Examining unusual relationships between monthly accounts payable balances and recorded cash payments.
- b. Reconciling vendor's statements to the file of receiving reports to identify items received just prior to the balance sheet date.
- ** c. Reviewing cash disbursements recorded subsequent to the balance sheet date to determine whether the related payables apply to the prior period.
- d. Investigating payables recorded just prior to and just subsequent to the balance sheet date to determine whether they are supported by receiving reports.

2. An auditor analyzes repairs and maintenance accounts primarily to obtain evidence in support of the assertions that all

- a. Noncapitalizable expenditures for repairs and maintenance have been properly charged to expense.
- ** b. Expenditures for property and equipment have not been charged to expense.
- c. Noncapitalizable expenditures for repairs and maintenance have been recorded in the proper period.
- d. Expenditures for property and equipment have been recorded in the proper period.

3. Which of the following procedures is least likely to be performed before the balance sheet date?

- a. Testing of internal control over cash.
- b. Confirmation of receivables.
- ** c. Search for unrecorded liabilities.
- d. Observation of inventory.

Chapter 16

16-21. These questions involve internal controls in the production cycle.

1. The objectives of the internal control structure for a production cycle are to provide assurance that transactions are properly executed and recorded, and that

- ** a. Independent internal verification of activity reports is established.
- b. Transfers to finished goods are documented by a completed production report and a quality control report.
- c. Production orders are prenumbered and signed by a supervisor.
- d. Custody of work in progress and finished goods is properly maintained.

2. An auditor's test of controls over the issuance of raw materials to production would most likely include

- a. Reconciling raw materials and work in progress perpetual inventory records to general ledger balances.
- b. Inquiring of the custodian about the procedures followed when defective materials are received from vendors.
- c. Observing that raw materials are stored in secure areas and that storeroom security is supervised by a responsible individual.
- ** d. Examining material requisitions and reperforming client controls designed to process and record issuances.

3. Independent internal verification of inventory occurs when employees who

- a. Issue raw materials obtain requisitions for each issue and prepare daily totals of materials issued.
- ** b. Compare records of goods on hand with physical quantities do **not** maintain the records or have custody of the inventory.
- c. Obtain receipts for the transfer of completed work to finished goods prepare a completed production report.
- d. Are independent of issuing production orders update records from completed job cost sheets and production cost reports on a timely basis.

4. Which of the following most likely would be an internal control procedure designed to detect misstatements concerning the custody of inventory?

- a. Periodic reconciliation of work in process with job cost sheets.
- ** b. Segregation of functions between general accounting and cost accounting.
- c. Independent comparisons of finished goods records with counts of goods on hand.
- d. Approval of inventory journal entries by the storekeeper.

16-22. These questions pertain to substantive tests of inventory balances.

1. In an audit of inventories, an auditor would **least** likely verify that

- a. All inventory owned by the client is on hand at the time of the count.
- b. The client has used proper inventory pricing.
- c. The financial statement presentation of inventories is appropriate.
- ** d. Damaged goods and obsolete items have been properly accounted for.

2. A client maintains perpetual inventory records in both quantities and dollars. If the assessed level of control risk is high, an auditor would probably

- a. Insist that the client perform physical counts of inventory items several times during the year.
- b. Apply gross profit tests to ascertain the reasonableness of the physical counts.
- c. Increase the extent of tests of controls of the inventory cycle.
- ** d. Request the client to schedule the physical inventory count at the end of the year.

3. The primary objective of a CPA's observation of a client's physical inventory count is to

- a. Discover whether a client has counted a particular inventory item or group of items.
- ** b. Obtain direct knowledge that the inventory exists and has been properly counted.
- c. Provide an appraisal of the quality of the merchandise on hand of the day of the physical count.
- d. Allow the auditor to supervise the conduct of the count to obtain assurance that the inventory quantities are reasonably accurate.

4. Which one of the following procedures would **not** be appropriate for an auditor in discharging his or her responsibilities concerning the client's physical inventories?

- a. Confirmation of goods in the hands of public warehouses.
- b. Supervising the taking of the annual physical inventory.
- ** c. Carrying out physical inventory procedures at an interim date.
- d. Obtaining written representation from the client as to the existence, quality, and dollar amount of the inventory.

11-23. These relate to internal controls in the personnel services cycle.

1. Effective internal control procedures over the payroll function may include

- a. Reconciliation of totals on job time tickets with job reports by employees responsible for those specific jobs.
- ** b. Verification of agreement of job time tickets with employee clock card hours by a payroll department employee.
- c. Preparation of payroll transaction journal entries by an employee who reports to the supervisor of the personnel department.
- d. Custody of rate authorization records by the supervisor of the payroll department.

2. In a computerized payroll system environment, an auditor would be **least** likely to use test data to test controls related to

- a. Missing employee numbers.
- ** b. Proper approval of overtime by supervisors.
- c. Time tickets with invalid job numbers.
- d. Agreement of hours per clock cards with hours on time tickets.

3. The sampling unit in a test of controls pertaining to the existence of payroll transactions ordinarily is a(an)

- a. Clock card or time ticket.
- b. Employee Form W-2.
- c. Employee personnel record.
- ** d. Payroll register entry.

4. An auditor who is testing EDP controls in a payroll system would most likely use test data that contain conditions such as

- a. Deductions **not** authorized by employees.
- b. Overtime **not** approved by supervisors.
- ** c. Time tickets with invalid job numbers.
- d. Payroll checks with unauthorized signatures.

Chapter 17

17-21. These questions relate to auditing the investing cycle.

1. An auditor testing long-term investments would ordinarily use analytical procedures to ascertain the reasonableness of the

- a. Existence of unrealized gains or losses in the portfolio.
- ** b. Completeness of recorded investment income.
- c. Classification between current and noncurrent portfolios.
- d. Valuation of marketable equity securities.

2. An auditor most likely verify the interest earned on bond investments by

- a. Vouching the receipt and deposit of interest checks.
- b. Confirming the bond interest rate with the issuer of the bonds.
- ** c. Recomputing the interest earned on the basis of face amount, interest rate, and period held.
- d. Testing the internal controls over cash receipts.

3. Which of the following controls would be most effective in assuring that the proper custody of assets in the investing cycle is maintained?

- a. Direct access to securities in the safety deposit box is limited to only one corporate officer.
- b. Personnel who post investment transactions to the general ledger are **not** permitted to update the investment subsidiary ledger.
- c. The purchase and sale of investments are executed on the specific authorization of the board of directors.
- ** d. The recorded balances in the investment subsidiary ledger are periodically compared with the contents of the safety deposit box by independent personnel.

4. To establish existence and ownership of a long-term investment in the common stock of a publicly traded company, an auditor ordinarily performs a security count or

- a. Relies on the client's internal controls if the auditor has reasonable assurance that that the control procedures are being applied as prescribed.
- ** b. Confirms the number of shares owned that are held by an independent custodian.
- c. Determines the market price per share at the balance sheet date from published quotations.
- d. Confirms the number of shares owned with the issuing company.

11-22. These questions apply to auditing the financing cycle.

1. An auditor's program to examine long-term debt most likely would include steps that require

- a. Comparing the carrying amount of the debt to its year-end market value.
- ** b. Correlating interest expense recorded for the period with outstanding data.
- c. Verifying the existence of the holders of the debt by direct confirmation.
- d. Inspecting the accounts payable subsidiary ledger for unrecorded long-term debt.

2. An auditor's program to examine long-term debt should include steps that require

- ** a. Examining bond trust indentures.
- b. Inspecting the accounts payable subsidiary ledger.
- c. Investigating credits to the bond interest income account.
- d. Verifying the existence of the bondholders.

3. An auditor should trace corporate stock issuances and treasury stock transactions to the

- a. Numbered stock certificates.
- b. Articles of incorporation.
- c. Transfer agent's records.
- ** d. Minutes of the board of directors.

4. When a client company does **not** maintain its own stock records, the auditor should obtain written confirmation from the transfer agent and registrar concerning

- a. Restrictions on the payments of dividends.
- ** b. The number of shares issued and outstanding.
- c. Guarantees of preferred stock liquidation value.
- d. The number of shares subject to agreements to repurchase.

Chapter 18

18-21. These questions relate to substantive tests of cash on hand and in bank.

1. The primary evidence regarding year-end bank balances is documented in the

- ** a. Standard bank confirmations.
- b. Bank reconciliations.
- c. Interbank transfer schedule.
- d. Bank deposit lead schedule.

2. Which of the following cash transfers results in a misstatement of cash at December 31, 1987?

<u>Transfer</u>	<u>Bank Transfer Schedule</u>			
	<u>Disbursement</u>		<u>Receipt</u>	
	<u>Recorded in books</u>	<u>Paid by bank</u>	<u>Recorded in books</u>	<u>Received by bank</u>
a.	12/31/87	1/4/88	12/31/87	12/31/87
** b.	1/4/88	1/5/88	12/31/87	1/4/88
c.	12/31/87	1/5/88	12/31/87	1/4/88
d.	1/4/88	1/11/88	1/4/88	1/4/88

3. The auditor's count of the client's cash should be coordinated to coincide with

- a. Study the internal control structure with respect to cash.
- b. Close of business on the balance sheet date.
- ** c. Count of marketable securities.
- d. Count of inventories.

4. Which of the following is one of the better auditing techniques that might be used by an auditor to detect kiting?

- a. Review composition of authenticated deposit slips.
- b. Review subsequent bank statements and canceled checks received directly from the banks.
- ** c. Prepare a schedule of bank transfers from the client's books.
- d. Prepare year-end bank reconciliations.

5. A cash shortage may be concealed by transporting funds from one location to another or by converting negotiable assets to cash. Because of this, which of the following is vital?

- a. Simultaneous confirmations.
- b. Simultaneous bank reconciliations.
- ** c. Simultaneous verification.
- d. Simultaneous surprise cash count.

11-22. These questions pertain to substantive tests for petty cash and lapping.

1. Under which of the following circumstances would an auditor be most likely to intensify an examination of a \$500 imprest petty cash fund?

- a. Reimbursement vouchers are not prenumbered.
- ** b. Reimbursement occurs twice each week.
- c. The custodian occasionally uses the cash fund to cash employee checks.
- d. The custodian endorses reimbursement checks.

2. An auditor confirms a representative number of open accounts receivable as of December 31, 19X2, and investigates respondents' exceptions and comments. By this procedure, the auditor would be most likely to learn of which of the following?

- ** a. One of the cashiers has been covering a personal embezzlement by lapping.
- b. One of the sales clerks has not been preparing charge slips for credit sales to family and friends.
- c. One of the EDP control clerks has been removing all sales invoices applicable to his account from the data file.
- d. The credit manager has misappropriated remittances from customers whose accounts have been written off.

3. Which of the following would be the best protection for a company that wishes to prevent the "lapping" of trade accounts receivable?

- a. Segregate duties so that the bookkeeper in charge of the general ledger has no access to incoming mail.
- b. Segregate duties so that no employee has access to both checks from customers and currency from daily cash receipts.
- ** c. Have customers send payments directly to the company's depository bank.
- d. Request that customers' payment checks to be made payable to the company and addressed to the treasurer.

Chapter 19

19-21. These questions pertain to subsequent events.

1. Which of the following procedures would an auditor ordinarily perform during the review of subsequent events?

- a. Review the cutoff bank statements for the period after the year-end.
- ** b. Inquire of the client's legal counsel concerning litigation.
- c. Investigate reportable conditions previously communicated to the client.
- d. Analyze related party transactions to discover possible irregularities.

2. An auditor is concerned with completing various phases of the examination after the balance sheet date. This "subsequent period" extends to the date of the

- ** a. Auditor's report.
- b. Final review of the audit working papers.
- c. Public issuance of the financial statements.
- d. Delivery of the auditor's report to the client.

3. A client acquired 25% of the outstanding capital stock after year-end and prior to completion of the auditor's field work. The auditor should

- a. Advise management to adjust the balance sheet to reflect the acquisition.
- b. Issue pro-forma financial statements giving effect to the acquisition as if it had occurred at year-end.
- ** c. Advise management to disclose the acquisition in the notes to the financial statements.
- d. Disclose the acquisition in the opinion paragraph of the auditor's report.

19-22. These questions relate to inquiries of client's lawyers and client "rep letters."

1. The scope of an audit is **not** restricted when an attorney's response to an auditor as a result of a client's letter of audit inquiry limits the response to

- ** a. Matters to which the attorney has given substantive attention in the form of legal representation.
- b. An evaluation of the likelihood of an unfavorable outcome of the matters disclosed by the entity.
- c. The attorney's opinion of the entity's historical experience in recent similar litigation.
- d. The probable outcome of asserted claims and pending or threatened litigation.

2. Auditors should request that an audit client send a letter of inquiry to those attorneys who have been consulted concerning litigation, claims, or assessments. The primary reason for this request is to provide

- a. Information concerning the progress of cases to date.
- ** b. Corroborative evidential matter.
- c. An estimate of the dollar amount of the probable loss.
- d. An expert opinion as to whether a loss is possible, probable, or remote.

3. Which of the following statements ordinarily is included among the written client representations obtained by the auditor?

- a. Sufficient evidential matter has been made available to permit the issuance of an unqualified opinion.
- ** b. Comprehensive balances and other arrangements involving restrictions on cash balances have been disclosed.
- c. Management acknowledges responsibility for illegal actions committed by employees.
- d. Management acknowledges that there are *no* material weaknesses in internal control.

4. Hall accepted an engagement to audit the 19X5 financial statements of XYZ Company. XYZ completed the preparation of the 19X5 financial statements on February 13, 19X6, and Hall began the field work on February 17, 19X6. Hall completed the field work on March 24, 19X6, and completed the report on March 28, 19X6. The client's representation letter normally would be dated

- a. February 13, 19X6.
- b. February 17, 19X6.
- ** c. March 24, 19X6.
- d. March 28, 19X6.

19-23. These questions pertain to the auditor's postaudit responsibilities.

1. An auditor issued an audit report that was dual dated for a subsequent event occurring after the completion of field work but before issuance of the auditor's report. The auditor's responsibility for events occurring subsequent to the completion of field work was

- ** a. Limited to the specific event referenced.
- b. Limited to include only events occurring before the date of the last subsequent event referenced.
- c. Extended to subsequent events occurring through the date of issuance of the report.
- d. Extended to include all events occurring since the completion of field work.

2. Six months after issuing an unqualified opinion on audited financial statements, an auditor discovered that the engagement personnel failed to confirm several of the client's material accounts receivable balances. The auditor should first

- a. Request the permission of the client to undertake the confirmation of accounts receivable.
- b. Perform alternative procedures to provide a satisfactory basis for the unqualified opinion.
- ** c. Assess the importance of the omitted procedures to the auditor's ability to support the previously expressed opinion.
- d. Inquire whether there are persons currently relying, or likely to rely, on the unqualified opinion.

3. Subsequent to the issuance to the auditor's report, the auditor became aware of facts existing at the report date that would have affected the report had the auditor then been aware of such facts. After determining that the information is reliable, the auditor should next

- a. Notify the board of directors that the auditor's report must no longer be associated with the financial statements.
- ** b. Determine whether there are persons relying or likely to rely on the financial statements who would attach importance to the information.
- c. Request that management disclose the effects of the newly discovered information by adding a footnote to subsequently issued financial statements.
- d. Issue revised pro-forma financial statements taking in to consideration the newly discovered information.

Chapter 20

20-21. These questions relate to the four reporting standards.

1. The fourth standard of reporting 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 the auditor is assuming.
- b. An auditor from reporting on one basic financial statement and not the others.
- c. An auditor from expressing different opinions on each of the basic financial statements.
- d. Restrictions on the scope of the examination, whether imposed by the client or by the inability to obtain evidence.

2. Which of the following requires recognition in the auditor's opinion as to consistency?

- a. The correction of an error in the prior year's financial statements resulting from a mathematical mistake in capitalizing interest.
- ** b. The change from the cost method to the equity method of accounting for investments in common stock.
- c. A change in the estimate of provisions for warranty costs.
- d. A change in depreciation method that has no effect on the current year's financial statements but is certain to affect future years.

3. The first standard of reporting requires that "the report shall state whether the financial statements are presented in accordance with generally accepted accounting principles." This should be construed to require

- a. A statement of fact by the auditor.
- ** b. An opinion by the auditor.
- c. An implied measure of fairness.
- d. An objective measure of compliance.

20-22. These questions relate to the type of opinion that an auditor should express.

1. Restrictions imposed by a client prohibit the observation of physical inventories, which account for 35% of all assets. Alternative auditing procedures cannot be applied, although the auditor was able to examine satisfactory evidence for all other items in the financial statements. The auditor should issue a(an)

- a. "Except for" qualified opinion.
- ** b. Disclaimer of opinion.
- c. Unqualified opinion with a separate explanatory paragraph.
- d. Unqualified opinion with an explanation in the scope paragraph.

2. Management of Hill Company has decided not to account for a material transaction in accordance with the provisions of an FASB standard. In setting forth its reasons in a note to the financial statements, management has clearly demonstrated that due to unusual circumstances the financial statements presented in accordance with the FASB standard would be misleading. The auditor's report should include a separate explanatory paragraph and contain a(an)

- a. "Except for" qualified opinion.
- b. "Subject to" qualified opinion.
- c. Adverse opinion.
- ** d. Unqualified opinion.

3. If a publicly held company issues financial statements that purport to present its financial position and results of operations but omits the statement of cash flows, the auditor ordinarily will express a(an)

- a. Unqualified opinion with a separate explanatory paragraph.
- b. Disclaimer of opinion.
- c. Adverse opinion.
- ** d. Qualified opinion.

20-23. These questions pertain to the form and content of the auditor's report.

1. When a qualified opinion results from a limitation on the scope of an audit, the situation should be described in an explanatory paragraph

- a. Preceding the opinion paragraph and referred to only in the scope paragraph of the auditor's report.
- b. Following the opinion paragraph and referred to in both the scope and opinion paragraphs of the auditor's report.
- c. Following the opinion paragraph and referred to only in the scope paragraph of the auditor's report.
- ** d. Preceding the opinion paragraph and referred to in both the scope and opinion paragraphs of the auditor's report.

2. An auditor's report that refers to the use of an accounting principle at variance with generally accepted accounting principles contains the words, "In our opinion, with the foregoing explanation, the financial statements referred to above present fairly..." This is considered an

- a. Adverse opinion.
- b. "Except for" qualified opinion.
- c. Unqualified opinion with an explanatory paragraph.
- ** d. Example of inappropriate reporting.

3. When a principal auditor decides to make reference to another auditor's examination, the principal auditor's report should always indicate clearly, in the introductory, scope, and opinion paragraphs, the

- a. Magnitude of the portion of the financial statements examined by the other auditor.
- b. Disclaimer of responsibility concerning the portion of the financial statements examined by the other auditor.
- c. Name of the other auditor.
- ** d. Divisions of responsibility.

20-24. These questions are based on other reporting considerations.

1. When reporting on comparative financial statements, an auditor ordinarily should change the previously issued opinions on the prior year's financial statements if

- a. The prior year's opinion was unqualified and the opinion on the current year's financial statements is modified due to a lack of consistency.
- b. The prior year's financial statements are restated following a pooling of interests in the current year.
- ** c. The prior year's financial statements are restated to conform with generally accepted accounting standards.
- d. The auditor is a predecessor auditor who has been requested by a former client to reissue the previously issued report.

2. The predecessor auditor, who is satisfied after properly communicating with the successor auditor, has reissued a report because the audit client desires comparative financial statements. The predecessor auditor's report should make

- a. Reference to the report of the successor auditor only in the scope paragraph.
- b. Reference to the work of the successor auditor in the scope and opinion paragraphs.
- c. Reference to both the work and the report of the successor auditor only in the opinion paragraph.
- ** d. No reference to the report or the work of the successor auditor.

3. An auditor concludes that there is a material inconsistency in the other information in an annual report to shareholders containing audited financial statements. If the auditor concludes that the financial statements do **not** require revision, but the client refuses to revise or eliminate the material inconsistency, the auditor may

- a. Issue an "except for" qualified opinion after discussing the matter with the client's board of directors.
- b. Consider the matter closed because the other information is **not** in the audited financial statements.
- c. Disclaim an opinion on the financial statements after explaining the material inconsistency in a separate explanatory paragraph.
- ** d. Revise the auditor's report to include a separate explanatory paragraph describing the material inconsistency.