

Auditing and Assurance Services, 14e (Arens)
Chapter 6 The CPA Profession

Learning Objective 6-1

- 1) The objective of the ordinary audit of financial statements is the expression of an opinion on:
- A) the fairness of the financial statements in all material respects.
 - B) the accuracy of the financial statements.
 - C) the accuracy of the annual report.
 - D) the accuracy of the balance sheet and income statement.

Answer: A

Terms: Objective of ordinary audit of financial statements

Diff: Easy

Objective: LO 6-1

AACSB: Reflective thinking skills

- 2) If the auditor believes that the financial statements are not fairly stated or is unable to reach a conclusion because of insufficient evidence, the auditor:
- A) should withdraw from the engagement.
 - B) should request an increase in audit fees so that more resources can be used to conduct the audit.
 - C) has the responsibility of notifying financial statement users through the auditor's report.
 - D) should notify regulators of the circumstances.

Answer: C

Terms: Auditor believes that financial statements are not fairly presented

Diff: Easy

Objective: LO 6-1

AACSB: Reflective thinking skills

- 3) Auditors accumulate evidence to:
- A) defend themselves in the event of a lawsuit.
 - B) justify the conclusions they have otherwise reached.
 - C) satisfy the requirements of the Securities Acts of 1933 and 1934.
 - D) enable them to reach conclusions about the fairness of the financial statements.

Answer: D

Terms: Auditors accumulate evidence

Diff: Easy

Objective: LO 6-1

AACSB: Reflective thinking skills

Learning Objective 6-2

1) The responsibility for adopting sound accounting policies and maintaining adequate internal control rests with the:

- A) board of directors.
- B) company management.
- C) financial statement auditor.
- D) company's internal audit department.

Answer: B

Terms: Responsibility for adopting sound accounting policies and maintaining adequate internal controls

Diff: Easy

Objective: LO 6-2

AACSB: Reflective thinking skills

2) If the auditor insists on financial statement disclosures that the management finds unacceptable, the auditor can:

A)

Issue an adverse audit report	Issue a qualified audit report
Yes	Yes

B)

Issue an adverse audit report	Issue a qualified audit report
No	No

C)

Issue an adverse audit report	Issue a qualified audit report
Yes	No

D)

Issue an adverse audit report	Issue a qualified audit report
No	Yes

Answer: A

Terms: Auditor insists on financial statement disclosures that management finds unacceptable

Diff: Easy

Objective: LO 6-2

AACSB: Reflective thinking skills

3) In certifying their annual financial statements, the CEO and CFO of a public company certify that the financial statements comply with the requirements of:

- A) GAAP.
- B) the Sarbanes-Oxley Act.
- C) the Securities Exchange Act of 1934.
- D) GAAS.

Answer: C

Terms: Certifying annual financial statements by CEO and CFO

Diff: Easy

Objective: LO 6-2

AACSB: Reflective thinking skills

Topic: Public

4) Which of the following statements is true of a public company's financial statements?

- A) Sarbanes-Oxley requires the CEO only to certify the financial statements.
- B) Sarbanes-Oxley requires the CFO only to certify the financial statements.
- C) Sarbanes-Oxley requires the CEO and CFO to certify the financial statements.
- D) Sarbanes-Oxley neither requires the CEO nor the CFO to certify the financial statements.

Answer: C

Terms: Public company's financial statements

Diff: Easy

Objective: LO 6-2

AACSB: Reflective thinking skills

Topic: SOX

5) The responsibility for the preparation of the financial statements and the accompanying footnotes belongs to:

- A) the auditor.
- B) management.
- C) both management and the auditor equally.
- D) management for the statements and the auditor for the notes.

Answer: B

Terms: Responsibility for preparation of the financial statements and the accompanying footnotes

Diff: Moderate

Objective: LO 6-2

AACSB: Reflective thinking skills

6) Responsibility for the fair presentation of financial statements rests equally with management and the auditor.

- A) True
- B) False

Answer: B

Terms: Responsibility for fair presentation of financial statements

Diff: Easy

Objective: LO 6-2

AACSB: Reflective thinking skills

Learning Objective 6-3

1) The auditor's best defense when material misstatements are not uncovered is to have conducted the audit:

- A) in accordance with generally accepted auditing standards.
- B) as effectively as reasonably possible.
- C) in a timely manner.
- D) only after an adequate investigation of the management team.

Answer: A

Terms: Auditors' best defense when material misstatements are not uncovered

Diff: Easy

Objective: LO 6-3

AACSB: Reflective thinking skills

2) In order to provide reasonable assurance the audit must be performed with an attitude of professional skepticism. Which of the following is most correct regarding the "attitude" of professional skepticism?

- A) auditors should assume that management is dishonest
- B) auditors should assume that management is neither dishonest nor honest
- C) auditors should assume that management is honest and mistakes are unintentional
- D) auditors should assume that management is incumbent in preparing financial statements

Answer: B

Terms: Attitude of professional skepticism

Diff: Easy

Objective: LO 6-3

AACSB: Reflective thinking skills

3) Which of the following is **not** one of the reasons that auditors provide only *reasonable* assurance on the financial statements?

- A) The auditor commonly examines a sample, rather than the entire population of transactions.
- B) Accounting presentations contain complex estimates which involve uncertainty.
- C) Fraudulently prepared financial statements are often difficult to detect.
- D) Auditors believe that reasonable assurance is sufficient in the vast majority of cases.

Answer: D

Terms: Reasons auditors provide only reasonable assurance on financial statements

Diff: Easy

Objective: LO 6-3

AACSB: Reflective thinking skills

4) Which of the following statements is most correct regarding errors and fraud?

- A) An error is unintentional, whereas fraud is intentional.
- B) Frauds occur more often than errors in financial statements.
- C) Errors are always fraud and frauds are always errors.
- D) Auditors have more responsibility for finding fraud than errors.

Answer: A

Terms: Errors and fraud

Diff: Easy

Objective: LO 6-3

AACSB: Reflective thinking skills

5) When an auditor believes that an illegal act may have occurred, the auditor should first:

- A) inquire of management at a level above those likely to be involved.
- B) consult with legal counsel of others knowledgeable about the illegal acts.
- C) accumulate additional evidence.
- D) withdraw from the engagement.

Answer: A

Terms: Auditor believes and illegal act may have occurred

Diff: Easy

Objective: LO 6-3

AACSB: Reflective thinking skills

6) The auditor has no responsibility to plan and perform the audit to obtain reasonable assurance that misstatements, whether caused by errors or fraud, that are not _____ are detected.

- A) important to the financial statements
- B) statistically significant to the financial statements
- C) material to the financial statements
- D) identified by the client

Answer: C

Terms: Auditor has no responsibility to plan and perform audit to obtain reasonable assurance

Diff: Easy

Objective: LO 6-3

AACSB: Reflective thinking skills

7) Fraudulent financial reporting is most likely to be committed by whom?

- A) line employees of the company
- B) outside members of the company's board of directors
- C) company management
- D) the company's auditors

Answer: C

Terms: Fraudulent financial reporting

Diff: Easy

Objective: LO 6-3

AACSB: Reflective thinking skills

8) Which of the following would most likely be deemed a direct-effect illegal act?

- A) violation of federal employment laws
- B) violation of federal environmental regulations
- C) violation of federal income tax laws
- D) violation of civil rights laws

Answer: C

Terms: Direct-effect illegal act

Diff: Easy

Objective: LO 6-3

AACSB: Reflective thinking skills

- 9) The concept of reasonable assurance indicates that the auditor is:
- A) not a guarantor of the correctness of the financial statements.
 - B) not responsible for the fairness of the financial statements.
 - C) responsible only for issuing an opinion on the financial statements.
 - D) responsible for finding all misstatements.

Answer: A

Terms: Concept of reasonable assurance

Diff: Easy

Objective: LO 6-3

AACSB: Reflective thinking skills

- 10) Which of the following is the auditor least likely to do when aware of an illegal act?
- A) Discuss the matter with the client's legal counsel.
 - B) Obtain evidence about the potential effect of the illegal act on the financial statements.
 - C) Contact the local law enforcement officials regarding potential criminal wrongdoing.
 - D) Consider the impact of the illegal act on the relationship with the company's management.

Answer: C

Terms: Illegal acts

Diff: Easy

Objective: LO 6-3

AACSB: Reflective thinking skills

- 11) Auditing standards require that an audit be designed to provide reasonable assurance of detecting:
- A) material errors in the financial statements.
 - B) fraud in the financial statements.
 - C) material errors and fraud in the financial statements.
 - D) inadequate disclosure in the notes to the financial statements.

Answer: A

Terms: Professional skepticism

Diff: Moderate

Objective: LO 6-3

AACSB: Reflective thinking skills

- 12) The auditor has considerable responsibility for notifying users as to whether or not the statements are properly stated. This imposes upon the auditor a duty to:
- A) provide reasonable assurance that material misstatements will be detected.
 - B) be a guarantor of the fairness in the statements.
 - C) be equally responsible with management for the preparation of the financial statements.
 - D) be an insurer of the fairness in the statements.

Answer: A

Terms: Auditor responsibility for notifying users as to whether statements are properly stated

Diff: Moderate

Objective: LO 6-3

AACSB: Reflective thinking skills

13) "The auditor should not assume that management is dishonest, but the possibility of dishonesty must be considered." This is an example of:

- A) unprofessional behavior.
- B) an attitude of professional skepticism.
- C) due diligence.
- D) a rule in the AICPA's Code of Professional Conduct.

Answer: B

Terms: Auditor should consider the possibility of dishonesty of management

Diff: Easy

Objective: LO 6-3

AACSB: Reflective thinking skills

14) If the auditor were responsible for making certain that all of management's assertions in the financial statements were absolutely correct:

- A) bankruptcies could no longer occur.
- B) bankruptcies would be reduced to a very small number.
- C) audits would be much easier to complete.
- D) audits would not be economically practical.

Answer: D

Terms: Auditor responsible for making certain that all of management's assertions were absolutely correct

Diff: Moderate

Objective: LO 6-3

AACSB: Reflective thinking skills

15) The auditor's best defense when existing material misstatements in the financial statements are not uncovered in the audit is:

- A) the audit was conducted in accordance with auditing standards.
- B) the financial statements are the client's responsibility.
- C) the client is guilty of contributory negligence.
- D) the client is guilty of fraudulent misrepresentation.

Answer: A

Terms: Auditor's best defense when existing material misstatements in the financial statements

Diff: Moderate

Objective: LO 6-3

AACSB: Reflective thinking skills

16) Which of the following is most correct with regard to the auditor's search of indirect-effect illegal acts that may have been committed by the client?

- A) No reason to search unless there is sufficient evidence to believe they have occurred.
- B) Same audit responsibility as the search for financial statement fraud.
- C) Same audit responsibility as the search for misappropriated assets.
- D) No reason to search as they would have an indirect effect on the financial statements.

Answer: A

Terms: Indirect-effect illegal acts

Diff: Moderate

Objective: LO 6-3

AACSB: Reflective thinking skills

17) Which of the following statements is usually true?

- A) It is easier for the auditor to uncover fraud than errors.
- B) It is easier for the auditor to uncover indirect-effect illegal acts than fraud.
- C) The auditor's responsibility for detecting direct-effect illegal acts is similar to the responsibility to detect fraud.
- D) The auditor's responsibility for detecting indirect-effect illegal acts is similar to the responsibility to detect fraud.

Answer: C

Terms: Auditors responsibility for detecting/uncovering misstatements

Diff: Challenging

Objective: LO 6-3

AACSB: Reflective thinking skills

18) Which of the following is most correct regarding the distinction(s) between the auditor's responsibilities for searching for errors and fraud.

- A) little
- B) a significant
- C) no
- D) various

Answer: C

Terms: Auditor responsibility for searching for errors and fraud

Diff: Moderate

Objective: LO 6-3

AACSB: Reflective thinking skills

19) In comparing management fraud with employee fraud, the auditor's risk of failing to discover the fraud is:

- A) greater for management fraud because managers are inherently more deceptive than employees.
- B) greater for management fraud because of management's ability to override existing internal controls.
- C) greater for employee fraud because of the higher crime rate among blue collar workers.
- D) greater for employee fraud because of the larger number of employees in the organization.

Answer: B

Terms: Management fraud vs. employee fraud and auditor failure to detect both

Diff: Moderate

Objective: LO 6-3

AACSB: Reflective thinking skills

20) Which of the following statements is correct with respect to the auditor's responsibilities relative to the detection of indirect-effect illegal acts?

- A) The auditor has no responsibility for searching for indirect-effect illegal acts.
- B) The auditor has the same responsibility for searching for indirect-effect illegal acts as any other potential misstatement that may occur.
- C) Auditors have responsibility for searching for any illegal act, whether direct-effect or indirect-effect.
- D) Discovery of indirect-effect illegal acts is usually easier than discovery of fraud.

Answer: A

Terms: Indirect-effect illegal acts

Diff: Moderate

Objective: LO 6-3

AACSB: Reflective thinking skills

21) When comparing the auditor's responsibility for detecting employee fraud and for detecting errors, the profession has placed the responsibility:

- A) more on discovering errors than employee fraud.
- B) more on discovering employee fraud than errors.
- C) equally on discovering either one.
- D) on the senior auditor for detecting errors and on the manager for detecting employee fraud.

Answer: C

Terms: Fraud and errors

Diff: Moderate

Objective: LO 6-3

AACSB: Reflective thinking skills

22) If several employees collude to falsify documents, the chance a normal audit would uncover such acts is:

- A) very low.
- B) very high.
- C) zero.
- D) none of the above.

Answer: A

Terms: Employees collude to falsify documents

Diff: Moderate

Objective: LO 6-3

AACSB: Reflective thinking skills

23) When planning the audit, if the auditor has no reason to believe that illegal acts exist, the auditor should:

- A) include audit procedures which have a strong probability of detecting illegal acts.
- B) still include some audit procedures designed specifically to uncover illegalities.
- C) ignore the issue.
- D) make inquiries of management regarding their policies for detecting and preventing illegal acts and regarding their knowledge of violations, and then rely on normal audit procedures to detect errors, irregularities, and illegalities.

Answer: D

Terms: Planning audit and illegal acts

Diff: Moderate

Objective: LO 6-3

AACSB: Reflective thinking skills

24) When the auditor has reason to believe an illegal act has occurred, the auditor should:

- A) inquire of management only at one level below those likely to be involved with the illegality.
- B) begin communication with the FASB in accordance with PCAOB regulations.
- C) consider accumulating additional evidence to determine if there is actually an illegal act.
- D) withdraw from the engagement.

Answer: C

Terms: Illegal acts occurred

Diff: Moderate

Objective: LO 6-3

AACSB: Reflective thinking skills

25) When the auditor knows that an illegal act has occurred, the auditor must:

- A) report it to the proper governmental authorities.
- B) consider the effects on the financial statements, including the adequacy of disclosure.
- C) withdraw from the engagement.
- D) issue an adverse opinion.

Answer: B

Terms: Auditor knows illegal act occurred

Diff: Moderate

Objective: LO 6-3

AACSB: Reflective thinking skills

26) If an auditor uncovers an illegal act at a public company, the auditor must notify:

- A) local law enforcement officials.
- B) the Public Company Accounting Oversight Board.
- C) the Securities and Exchange Commission.
- D) all of the above.

Answer: C

Terms: Auditor uncovers illegal act at public company

Diff: Moderate

Objective: LO 6-3

AACSB: Reflective thinking skills

Topic: Public

27) If an auditor conducted an audit in accordance with auditing standards, which of the following would the auditor likely detect?

- A) unrecorded transactions
- B) errors in postings of recorded transactions
- C) counterfeit signatures on paid checks
- D) fraud involving collusion

Answer: B

Terms: Auditor conducted audit in accordance with auditing standards

Diff: Moderate

Objective: LO 6-3

AACSB: Reflective thinking skills

28) Which of the following statements best describes the auditor's responsibility with respect to illegal acts that do not have a material effect on the client's financial statements?

- A) Generally, the auditor is under no obligation to notify parties other than personnel within the client's organization.
- B) Generally, the auditor is under an obligation to inform the PCAOB.
- C) Generally, the auditor is obligated to disclose the relevant facts in the auditor's report.
- D) Generally, the auditor is expected to compel the client to adhere to requirements of the Foreign Corrupt Practices Act.

Answer: A

Terms: Auditor responsibility with respect to illegal acts

Diff: Moderate

Objective: LO 6-3

AACSB: Reflective thinking skills

29) Which of the following statements best describes the auditor's responsibility regarding the detection of fraud?

- A) The auditor is responsible for the failure to detect fraud only when such failure clearly results from nonperformance of audit procedures specifically described in the engagement letter.
- B) The auditor is required to provide reasonable assurance that the financial statements are free of both material errors and fraud
- C) The auditor may extend auditing procedures to actively search for evidence of fraud where the examination indicates that fraud may exist.
- D) The auditor is responsible for the failure to detect fraud only when an unqualified opinion is issued.

Answer: B

Terms: Auditor responsibility regarding detection of fraud

Diff: Moderate

Objective: LO 6-3

AACSB: Reflective thinking skills

30) The essence of the attest function is to:

- A) assure the consistent application of correct accounting procedures.
- B) determine whether the client's financial statements are fairly stated in accordance with an applicable financial reporting framework such as U.S. GAAP or IFRS.
- C) examine individual transactions so that the auditor may certify as to their validity.
- D) detect collusion and fraud.

Answer: B

Terms: Essence of attest function

Diff: Moderate

Objective: LO 6-3

AACSB: Reflective thinking skills

31) The auditor's evaluation of the likelihood of material employee fraud is normally done initially as a part of:

- A) tests of controls.
- B) tests of transactions.
- C) understanding the entity's internal control.
- D) the assessment of whether to accept the audit engagement.

Answer: C

Terms: Evaluation of likelihood of material employee fraud

Diff: Challenging

Objective: LO 6-3

AACSB: Reflective thinking skills

32) Illegal acts are defined in auditing standards as:

- A) violations of laws or government regulations.
- B) violations of laws or government regulations other than errors.
- C) violations of laws or government regulations other than fraud.
- D) violations of law which would result in the arrest of the perpetrator.

Answer: C

Terms: Illegal acts

Diff: Challenging

Objective: LO 6-3

AACSB: Reflective thinking skills

33) Most illegal acts affect the financial statements:

- A) directly.
- B) only indirectly.
- C) both directly and indirectly.
- D) materially if direct; immaterially if indirect.

Answer: B

Terms: Illegal acts effect on financial statements

Diff: Challenging

Objective: LO 6-3

AACSB: Reflective thinking skills

34) With respect to the detection of indirect-effect illegal acts, auditing standards state that the auditor provides:

- A) no assurance that they will be detected.
- B) the same reasonable assurance provided for other items.
- C) assurance that they will be detected, if material.
- D) assurance that they will be detected, if highly material.

Answer: A

Terms: Detection of indirect-effect illegal acts

Diff: Challenging

Objective: LO 6-3

AACSB: Reflective thinking skills

35) An auditor should recognize that the application of auditing procedures may produce evidence indicating the possibility of errors or fraud and therefore should:

- A) plan and perform the engagement with an attitude of professional skepticism.
- B) not rely on internal controls that are designed to prevent or detect errors or fraud.
- C) design audit tests to detect unrecorded transactions.
- D) extend the work to audit most recorded transactions and records of an entity.

Answer: A

Terms: Audit procedures that product evidence of errors or fraud

Diff: Challenging

Objective: LO 6-3

AACSB: Reflective thinking skills

36) Discuss the differences between errors, frauds, and illegal acts. Give an example of each.

Answer: The primary difference between errors and frauds is that errors are unintentional misstatements of the financial statements, whereas frauds are intentional misstatements. Illegal acts are violations of laws or government regulations, other than frauds. An example of an error is a mathematical mistake when footing the columns in the sales journal. An example of a fraud is the creation of fictitious accounts receivable. An example of an illegal act is the dumping of toxic waste in violation of the federal environmental protection laws.

Terms: Errors, frauds, and illegal acts

Diff: Easy

Objective: LO 6-3

AACSB: Reflective thinking skills

37) Discuss the actions an auditor should take when the auditor discovers an illegal act.

Answer:

1. The auditor should first consider the effects of the illegal act on the financial statements, including the adequacy of disclosures. If the auditor concludes that disclosures are inadequate, the audit report should be modified accordingly. The auditor should also consider the effect of the illegal act on its relationship with management, and management's trustworthiness.
2. The client's audit committee or others of equivalent authority should be informed of the illegal act. If the client does not deal with the illegal act in a satisfactory manner, the auditor should consider withdrawing from the engagement.

Finally, if the client is publicly held, the auditor may need to report the matter to the SEC.

Terms: Actions auditor should take when auditor discovers illegal act

Diff: Moderate

Objective: LO 6-3

AACSB: Reflective thinking skills

38) Discuss three reasons why auditors are responsible for "reasonable" but not "absolute" assurance.

Answer:

- Most audit evidence results from testing a sample of a population. Sampling involves some risk of not uncovering material misstatements.
- Accounting presentations contain complex estimates, which inherently involve uncertainty and can be affected by future events. As a result, the auditor has to rely on evidence that is persuasive but not convincing.
- Fraudulently prepared financial statements are often very difficult for the auditor to detect, especially when there is collusion among management.

Terms: Reasons auditors are responsible for reasonable but not absolute assurance

Diff: Moderate

Objective: LO 6-3

AACSB: Reflective thinking skills

39) Discuss the differences in the auditor's responsibilities for discovering (1) material errors, (2) material fraud (3) direct-effect illegal acts, and (4) indirect-effect illegal acts.

Answer: Auditing standards make no distinction between the auditor's responsibilities for searching for errors and fraud. In either case, the auditor must obtain reasonable assurance about whether the statements are free of material misstatements. The standards also recognize that fraud is often more difficult to detect because management or the employees perpetrating the fraud *attempt to conceal the fraud*. Still, the difficulty of detection does not change the auditor's responsibility to properly plan and perform the audit to detect material misstatements, whether caused by error or fraud. The auditor's responsibility for uncovering direct-effect illegal acts is the same as for errors and fraud. However, the auditor is not required to search for indirect-effect illegal acts unless there is reason to believe they exist.

Terms: Auditor responsibilities for discovering material errors, material fraud, direct-effect illegal acts, and indirect-effect illegal acts

Diff: Challenging

Objective: LO 6-3

AACSB: Reflective thinking skills

40) Errors are usually more difficult for an auditor to detect than frauds.

A) True

B) False

Answer: B

Terms: Auditor detection of errors and frauds

Diff: Easy

Objective: LO 6-3

AACSB: Reflective thinking skills

41) Other than inquiring of management about policies they have established to prevent illegal acts and whether management knows of any laws or regulations that the company has violated, the auditor should not search for indirect-effect illegal acts unless there is reason to believe they may exist.

A) True

B) False

Answer: A

Terms: Auditor responsibility for searching for indirect-effect illegal acts

Diff: Easy

Objective: LO 6-3

AACSB: Reflective thinking skills

42) When an auditor believes that an illegal act may have occurred, the first step he or she should take is to gather additional evidence to determine the extent of the illegality.

A) True

B) False

Answer: A

Terms: Auditor believes illegal act may have occurred

Diff: Easy

Objective: LO 6-3

AACSB: Reflective thinking skills

43) Audits are expected to provide a higher degree of assurance for the detection of material frauds than is provided for an equally material error.

A) True

B) False

Answer: B

Terms: Degree of assurance for detection of material frauds and errors

Diff: Moderate

Objective: LO 6-3

AACSB: Reflective thinking skills

44) Auditors have a higher degree of responsibility for detecting direct-effect illegal acts than indirect-effect illegal acts.

A) True

B) False

Answer: A

Terms: Auditor degree of responsibility for detecting direct-effect and indirect-effect illegal acts

Diff: Moderate

Objective: LO 6-3

AACSB: Reflective thinking skills

45) The auditor's first course of action when an illegal act is uncovered should be to immediately notify the appropriate authorities, including but not limited to the police, and for publicly held companies, the Securities and Exchange Commission.

A) True

B) False

Answer: B

Terms: Illegal act uncovered

Diff: Moderate

Objective: LO 6-3

AACSB: Reflective thinking skills

46) An audit generally provides no assurance that indirect-effect illegal acts will be detected.

A) True

B) False

Answer: A

Terms: Indirect-effect illegal acts; No assurance

Diff: Moderate

Objective: LO 6-3

AACSB: Reflective thinking skills

47) Auditing standards indicate that reasonable assurance is a moderate, but not absolute, level of assurance that the financial statements are free of material misstatement.

A) True

B) True

Answer: B

Terms: Moderate or high risk of management fraud

Diff: Moderate

Objective: LO 6-3

AACSB: Reflective thinking skills

48) An auditor must inform a client's audit committee of an illegal act discovered during an audit in writing.

A) True

B) False

Answer: B

Terms: Auditor to inform of illegal act discovered during an audit

Diff: Challenging

Objective: LO 6-3

AACSB: Reflective thinking skills

49) The objective of the audit of financial statements by an independent auditor is to verify that the financial statements are free of misstatements and accurately represent the company's financial position and results of operations.

A) True

B) False

Answer: B

Terms: Objective of audit of financial statements

Diff: Challenging

Objective: LO 6-3

AACSB: Reflective thinking skills

50) The auditor's responsibility for uncovering direct-effect illegal acts is the same as for fraud.

A) True

B) False

Answer: A

Terms: Auditor responsibility for uncovering direct-effect illegal acts and fraud

Diff: Challenging

Objective: LO 6-3

AACSB: Reflective thinking skills

Learning Objective 6-4

1) Why does the auditor divide the financial statements into smaller segments?

A) Using the cycle approach makes the audit more manageable.

B) Most accounts have few relationships with others and so it is more efficient to break the financial statements into smaller pieces.

C) The cycle approach is used because auditing standards require it.

D) All of the above are correct.

Answer: A

Terms: Reason auditor divides financial statements into smaller segments

Diff: Moderate

Objective: LO 6-4

AACSB: Reflective thinking skills

2) Why does the auditor divide the financial statements into segments around the financial statement cycles?

A) Most auditors are trained to audit cycles as opposed to entire financial statements.

B) The approach aids in the assignment of tasks to different members of the audit team.

C) The cycle approach is required by auditing standards.

D) The cycle approach allows the auditor to detect indirect-effect illegal acts.

Answer: B

Terms: Reason auditor divides financial statements into smaller segments

Diff: Moderate

Objective: LO 6-4

AACSB: Reflective thinking skills

3) The most important general ledger account included in and affecting several cycles is the:

A) cash account.

B) inventory account.

C) income tax expense and liability accounts.

D) retained earnings account.

Answer: A

Terms: Account included in and affected several cycles

Diff: Moderate

Objective: LO 6-4

AACSB: Reflective thinking skills

4) When using the cycle approach to segmenting the audit, the reason for treating capital acquisition and repayment separately from the acquisition of goods and services is that:

- A) the transactions are related to financing a company rather than to its operations.
- B) most capital acquisition and repayment cycle accounts involve few transactions, but each is often highly material and therefore should be audited extensively.
- C) both A and B are correct.
- D) neither A nor B is correct.

Answer: C

Terms: Cycle approach to segmenting an audit

Diff: Challenging

Objective: LO 6-4

AACSB: Reflective thinking skills

5) In describing the cycle approach to segmenting an audit, which of the following statements is **not** true?

- A) All general ledger accounts and journals are included at least once.
- B) Some journals and general ledger accounts are included in more than one cycle.
- C) The "capital acquisition and repayment" cycle is closely related to the "acquisition of goods and services and payment" cycle.
- D) The "inventory and warehousing" cycle may be audited at any time during the engagement since it is unrelated to the other cycles.

Answer: D

Terms: Cycle approach to segmenting an audit

Diff: Challenging

Objective: LO 6-4

AACSB: Reflective thinking skills

6) Which of the following journals would be included most often in the various audit cycles?

- A) cash receipts journal
- B) cash disbursements journal
- C) general journal
- D) sales journal

Answer: C

Terms: Journal included most often in various audit cycles

Diff: Challenging

Objective: LO 6-4

AACSB: Reflective thinking skills

7) Auditors generally use a financial statement cycle approach when performing a financial statement audit. Describe the transaction flow, using specific examples, from journals to financial statements that produce financial statements.

Answer: Transactions—sales, cash receipts, acquisition of goods/services, cash disbursements, payroll services and disbursements, and allocation and adjustments

Journals—sales, cash receipts, acquisitions, cash disbursements, payroll, and general

General ledger and subsidiary ledgers to General ledger trial balance to financial statements

Terms: Financial statement cycle approach when performing a financial statement audit

Diff: Moderate

Objective: LO 6-4

AACSB: Reflective thinking skills

8) Under the cycle approach to segmenting an audit, transactions recorded in different journals should never be combined with the general ledger balances that result from those transactions.

A) True

B) False

Answer: B

Terms: Cycle approach to segmenting an audit

Diff: Moderate

Objective: LO 6-4

AACSB: Reflective thinking skills

Learning Objective 6-5

1) There are no questions for this Learning Objective.

Answer:

Learning Objective 6-6

1) Which of the following is not one of the three categories of assertions?

A) Assertions about classes of transactions and events for the period under audit

B) Assertions about financial statements and correspondence to GAAP

C) Assertions about account balances at period end

D) Assertions about presentation and disclosure

Answer: B

Terms: Categories of assertions

Diff: Easy

Objective: LO 6-6

AACSB: Reflective thinking skills

2) If a short-term note payable is included in the accounts payable balance on the financial statement, there is a violation of the:

A) completeness assertion.

B) existence assertion.

C) cutoff assertion.

D) classification and understandability assertion.

Answer: D

Terms: Violation of assertions

Diff: Easy

Objective: LO 6-6

AACSB: Reflective thinking skills

3) International auditing standards and U.S. GAAP classify assertions into three categories. Which of the following is not a category of assertions that management makes about the accounting information in financial statements?

- A) Assertions about classes of transactions for the period under audit
- B) Assertions about account balances at period end
- C) Assertions about the quality of source documents used to prepare the financial statements
- D) Assertions about presentation and disclosure

Answer: C

Terms: Management assertions

Diff: Easy

Objective: LO 6-6

AACSB: Reflective thinking skills

4) Management assertions are:

- A) directly related to the financial reporting framework used by the company, usually U.S. GAAP or IFRS
- B) stated in the footnotes to the financial statements.
- C) explicitly expressed representations about the financial statements.
- D) provided to the auditor in the assertions letter, but are not disclosed on the financial statements.

Answer: A

Terms: Management assertions

Diff: Moderate

Objective: LO 6-6

AACSB: Reflective thinking skills

5) Which of the following statements is true?

- A) Auditors have generally found that the most effective and efficient way to conduct an audit is to obtain some assurance for each class of transaction and for the ending balance of the related account.
- B) Management's assertions follow and are closely related to the audit objectives.
- C) The auditor's primary responsibility is to find and disclose fraudulent management assertions.
- D) Assertions about presentation and disclosure deal with whether the accounts have been included in the financial statements at appropriate amounts.

Answer: A

Terms: Management assertions

Diff: Moderate

Objective: LO 6-6

AACSB: Reflective thinking skills

6) Which of the following statements about the existence and completeness assertions is not true?

- A) The existence and completeness assertions emphasize different audit concerns.
- B) Existence deals with overstatements and completeness deals with understatements.
- C) Existence deals with understatements and completeness deals with overstatements.
- D) The completeness assertion deals with unrecorded transactions.

Answer: C

Terms: Existence and completeness assertions

Diff: Moderate

Objective: LO 6-6

AACSB: Reflective thinking skills

7) Which of the following assertions is described as "this assertion addresses whether all transactions that should be included in the financial statements are in fact included"?

- A) occurrence
- B) completeness
- C) rights and obligations
- D) existence

Answer: B

Terms: Assertion which addresses whether all transactions that should be included are included

Diff: Moderate

Objective: LO 6-6

AACSB: Reflective thinking skills

8) Which of the following management assertions is not associated with transaction-related audit objectives?

- A) Occurrence
- B) Classification and understandability
- C) Accuracy
- D) Completeness

Answer: B

Terms: Management assertion not associated with transaction-related audit objectives

Diff: Moderate

Objective: LO 6-6

AACSB: Reflective thinking skills

9) Briefly explain each management assertion related to classes of transactions and events for the period under audit.

Answer:

- *Occurrence*. Transactions and events that have been recorded have occurred and pertain to the entity.
- *Completeness*. All transactions and events that should have been recorded have been recorded.
- *Accuracy*. Amounts and other data relating to recorded transactions and events have been recorded appropriately.
- *Classification*. Transactions and events have been recorded in the proper accounts.
- *Cutoff*. Transactions and events have been recorded in the correct accounting period.

Terms: Management assertions related to classes of transactions

Diff: Moderate

Objective: LO 6-6

AACSB: Reflective thinking skills

10) Briefly explain each management assertion related to account balances at period end.

Answer:

- *Existence*. Assets, liabilities, and equity interests exist.
- *Completeness*. All assets, liabilities, and equity interests that should have been recorded have been recorded.
- *Valuation and allocation*. Assets, liabilities, and equity interests are included in the financial statements at appropriate amounts and any resulting valuation adjustments are appropriately recorded.
- *Rights and obligations*. The entity holds or controls the rights to assets, and liabilities are the obligation of the entity.

Terms: Management assertions related to account balances at period end

Diff: Moderate

Objective: LO 6-6

AACSB: Reflective thinking skills

11) Briefly explain each management assertion related to presentation and disclosure.

Answer:

- *Occurrence and rights and obligations*. Disclosed events and transactions have occurred and pertain to the entity.
- *Completeness*. All disclosures that should have been included in the financial statements have been included.
- *Accuracy and valuation*. Financial and other information are disclosed appropriately and at appropriate amounts.
- *Classification and understandability*. Financial and other information is appropriately presented and described and disclosures are clearly expressed.

Terms: Management assertions related to presentation and disclosure

Diff: Moderate

Objective: LO 6-6

AACSB: Reflective thinking skills

Learning Objective 6-7

1) Which of the following statements is true regarding the distinction between general audit objectives and specific audit objectives for each account balance?

- A) The specific audit objectives are applicable to every account balance on the financial statements.
- B) The general audit objectives are applicable to every account balance on the financial statements.
- C) The general audit objectives are stated in terms tailored to the engagement.
- D) For any given class of transactions, usually only one audit objective must be met to conclude the transactions are properly recorded.

Answer: B

Terms: Difference between general and specific audit objectives

Diff: Moderate

Objective: LO 6-7

AACSB: Reflective thinking skills

2) The auditor is determining that the recorded sales are for the amount of goods shipped are correctly billed and recorded. She is gathering evidence about which transaction related audit objective?

- A) existence
- B) completeness
- C) accuracy
- D) cut-off

Answer: C

Terms: Evidence for transaction related audit objective if recorded sales are for amount shipped and correctly billed and recorded

Diff: Moderate

Objective: LO 6-7

AACSB: Analytic skills

3) Which of the following combinations is correct?

- A) Existence relates to whether the amounts in accounts are understated.
- B) Occurrence relates to whether balances exist.
- C) Existence relates to whether amounts included exist.
- D) Occurrence relates to whether the amounts in accounts occurred in the proper year.

Answer: C

Terms: Existence and occurrence objectives

Diff: Moderate

Objective: LO 6-7

AACSB: Reflective thinking skills

4) After general audit objectives are understood, specific audit objectives for each account balance on the financial statements can be developed. Which of the following statements is true?

- A) There should be at least one specific objective for each relevant general objective.
- B) There will be only one specific objective for each relevant general objective.
- C) There will be many specific objectives developed for each relevant general objective.
- D) There must be one specific objective for each general objective.

Answer: A

Terms: General and specific audit objectives

Diff: Challenging

Objective: LO 6-7

AACSB: Reflective thinking skills

5) In the context of the audit of sales, distinguish between the existence and completeness transaction-related audit objectives. State the effect on the sales account (overstatement or understatement) of a violation of each objective.

Answer: When testing the existence objective for sales, the auditor's focus is on whether the sales that have been recorded in the sales journal actually occurred. In contrast, tests of the completeness objective are concerned with determining whether all sales that actually occurred have been recorded in the sales journal. Violations of the existence objective result in overstatements of sales; violations of the completeness objective result in understatements of sales.

Terms: Existence and completeness transaction-related audit objectives

Diff: Moderate

Objective: LO 6-7

AACSB: Reflective thinking skills

6) Below are five audit procedures, all of which are tests of transactions associated with the audit of the sales and collection cycle. Also below are the six general transaction-related audit objectives and the five management assertions. For each audit procedure, indicate (1) its audit objective, and (2) the management assertion being tested.

<u>Audit Objectives</u>	<u>Assertions</u>
A. Occurrence	V. Occurrence
B. Completeness	W. Completeness
C. Accuracy	X. Accuracy
D. Posting and summarization	Y. Classification
E. Classification	Z. Cutoff
F. Timing	

1. Vouch recorded sales from the sales journal to the file of bills of lading.

(1) _____.

(2) _____.

2. Compare dates on the bill of lading, sales invoices, and sales journal to test for delays in recording sales transactions.

(1) _____.

(2) _____.

3. Account for the sequence of prenumbered bills of lading and sales invoices.

(1) _____.

(2) _____.

4. Trace from a sample of prelistings of cash receipts to the cash receipts journal, testing for names, amounts, and dates.

(1) _____.

(2) _____.

5. Examine customer order forms for credit approval by the credit manager.

(1) _____.

(2) _____.

Answer:

1. (1) A (2) V

2. (1) F (2) Z

3. (1) B (2) W

4. (1) B, C (2) W, X

5. (1) A (2) V

Terms: Management assertions and transaction-related audit objectives

Diff: Challenging

Objective: LO 6-6 and LO 6-7

AACSB: Analytic skills

7) Below are five audit procedures, all of which are tests of transactions associated with the audit of the acquisition and payment cycle. Also below are the six general transaction-related audit objectives and the five management assertions. For each audit procedure, indicate (1) its audit objective, and (2) the management assertion being tested.

<u>Audit Objectives</u>	<u>Assertions</u>
A. Occurrence	V. Occurrence
B. Completeness	W. Completeness
C. Accuracy	X. Accuracy
D. Posting and summarization	Y. Classification
E. Classification	Z. Cutoff
F. Timing	

1. Foot the purchases journal and trace the totals to the related general ledger accounts.

(1) _____.

(2) _____.

2. Recompute the cash discounts taken by the client.

(1) _____.

(2) _____.

3. Compare dates on cancelled checks with the bank cancellation date.

(1) _____.

(2) _____.

4. Trace from a sample of cancelled checks to the cash disbursements journal.

(1) _____.

(2) _____.

5. Examine supporting documentation for a sample of transactions for authorized payee and amount and to determine services or goods were received.

(1) _____.

(2) _____.

Answer:

1. (1) D (2) X

2. (1) C (2) X

3. (1) F (2) Z

4. (1) B (2) W

5. (1) A (2) V

Terms: Management assertions and transaction-related audit objectives

Diff: Challenging

Objective: LO 6-6 and LO 6-7

AACSB: Analytic skills

8) General transaction-related audit objectives vary from audit to audit, depending on the nature and characteristics of the client's business and industry.

A) True

B) False

Answer: B

Terms: General transaction-related audit objectives

Diff: Moderate

Objective: LO 6-7

AACSB: Reflective thinking skills

9) The audit objective of posting and summarization is associated with the management assertion of accuracy.

A) True

B) False

Answer: A

Terms: Audit objective of posting and summarization; Accuracy management assertion

Diff: Moderate

Objective: LO 6-7

AACSB: Reflective thinking skills

10) The transaction-related audit objective of timing is related to the assertion of cutoff.

A) True

B) False

Answer: A

Terms: Transaction-related audit objective of timing; Cutoff assertion

Diff: Moderate

Objective: LO 6-7

AACSB: Reflective thinking skills

11) The effect of a violation of the existence transaction-related audit objective for the sales account would be an overstatement of that account.

A) True

B) False

Answer: A

Terms: Existence transaction-related audit objective

Diff: Moderate

Objective: LO 6-7

AACSB: Reflective thinking skills

12) The effect of a violation of the completeness transaction-related audit objective for cash disbursements transactions would be an overstatement of cash disbursements.

A) True

B) False

Answer: B

Terms: Completeness transaction-related audit objective

Diff: Moderate

Objective: LO 6-7

AACSB: Reflective thinking skills

13) The transaction-related audit objective that deals with whether recorded transactions have actually occurred is the completeness objective.

A) True

B) False

Answer: B

Terms: Transaction-related audit objective; Completeness objective

Diff: Moderate

Objective: LO 6-7

AACSB: Reflective thinking skills

Learning Objective 6-8

1) In testing for cutoff, the objective is to determine:

A) whether all of the current period's transactions are recorded.

B) whether transactions are recorded in the correct accounting period.

C) the proper cutoff between capitalizing and expensing expenditures.

D) the proper cutoff between disclosing items in footnotes or in account balances.

Answer: B

Terms: Objective in testing cutoff

Diff: Moderate

Objective: LO 6-8

AACSB: Reflective thinking skills

2) The detail tie-in objective is not concerned that the details in the account balance:

A) agree with related subsidiary ledger amounts.

B) are properly disclosed in accordance with GAAP.

C) foot to the total in the account balance.

D) agree with the total in the general ledger.

Answer: B

Terms: Detail tie-in objective

Diff: Moderate

Objective: LO 6-8

AACSB: Reflective thinking skills

3) The detail tie-in is part of the _____ assertion for account balances.

A) classification

B) valuation and allocation

C) rights and obligations

D) completeness

Answer: B

Terms: Detail tie-in is and assertion for account balances

Diff: Moderate

Objective: LO 6-8

AACSB: Reflective thinking skills

4) The primary difference between an audit of the balance sheet and an audit of the income statement is that the audit of the income statement deals with the verification of:

- A) transactions.
- B) balances.
- C) costs.
- D) cutoffs.

Answer: A

Terms: Difference between audit of balance sheet and income statement

Diff: Moderate

Objective: LO 6-8

AACSB: Reflective thinking skills

5) Which of the following best describes tests of details of balances?

- A) audit procedures designed to test for monetary misstatements in the accounts summarized in the financial statements
- B) audit procedures designed to test for the monetary amounts of transactions
- C) audit procedures designed to test for reasonableness of account balances
- D) audit procedures designed to test for effectiveness in recording accounting information

Answer: A

Terms: Details of balances

Diff: Challenging

Objective: LO 6-8

AACSB: Reflective thinking skills

6) Which of the following statements is not true?

- A) Balance-related audit objectives are applied to ending account balances.
- B) Transaction-related audit objectives are applied to classes of transactions.
- C) Balance-related audit objectives are applied to the ending balance in balance sheet accounts.
- D) Balance-related audit objectives are applied to both beginning and ending balances in balance sheet accounts.

Answer: D

Terms: Balance-related and transaction-related audit objectives

Diff: Moderate

Objective: LO 6-7 and LO 6-8

AACSB: Reflective thinking skills

7) An important balance related objective is realizable value. Describe what is the purpose of this audit objective, what it is concerned with, and give an example.

Answer: Purpose—assets are included on the balance sheet at the amounts estimated to be realized.

Concept—whether an account balance has been reduced for declines from historical cost or when accounting standards require a fair value accounting treatment for the account. It is concerned with valuation and allocation.

Example—allowance for uncollectible accounts, write-downs of inventory.

Terms: Balance related objective of realizable value

Diff: Challenging

Objective: LO 6-8

AACSB: Reflective thinking skills

8) Below are five audit procedures, all of which are tests of balances associated with the audit of accounts

receivable. Also below are the eight general balance-related audit objectives and the four management assertions. For each audit procedure, indicate (1) its audit objective, and (2) the management assertion being tested.

<u>Audit Objectives</u>	<u>Assertions</u>
A. Existence	V. Existence
B. Completeness	W. Completeness
C. Accuracy	X. Valuation and allocation
D. Classification	Y. Rights and obligations
E. Cutoff	
F. Detail tie-in	
G. Realizable value	
H. Rights and obligations	

1. Obtain an aged listing of accounts receivable. For a sample of individual customers on the listing, agree the customer's name, amount, and other information with the corresponding information in the accounts receivable master file.

- (1) _____.
 (2) _____.

2. Examine details of sales for five days before and five days after year-end to determine whether sales have been recorded in the proper period.

- (1) _____.
 (2) _____.

3. Assess the reasonableness of the balance in the allowance for doubtful accounts.

- (1) _____.
 (2) _____.

4. Inquire as to whether any accounts receivable have been factored or sold during the period.

- (1) _____.
 (2) _____.

5. Inquire as to whether there are any receivables from related parties.

- (1) _____.
 (2) _____.

Answer:

1. (1) F (2) X
 2. (1) E (2) X
 3. (1) G (2) X
 4. (1) H (2) Y
 5. (1) D (2) X

Terms: Management assertions and balance-related audit objectives

Diff: Challenging

Objective: LO 6-6 and LO 6-8

AACSB: Analytic skills

9) Auditors have found that the most efficient way to conduct audits is to focus primarily on testing classes of transactions and performing tests of ending account balances.

A) True

B) False

Answer: A

Terms: Testing classes of transactions and ending account balances

Diff: Easy

Objective: LO 6-7 and LO 6-8

AACSB: Reflective thinking skills

10) Balance-related audit objectives are usually applied to the ending balance in income statement accounts; transaction-related audit objectives are usually applied to transactions reflected in balance sheet accounts.

A) True

B) False

Answer: B

Terms: Balance-related audit objectives; Transaction-related audit objectives

Diff: Moderate

Objective: LO 6-7 and LO 6-8

AACSB: Reflective thinking skills

11) Tests of details of balances typically involve the use of comparisons and relationships to assess the overall reasonableness of account balances.

A) True

B) False

Answer: B

Terms: Test of details of balances

Diff: Easy

Objective: LO 6-8

AACSB: Reflective thinking skills

12) The general balance-related audit objective that deals with determining that details in the account balance agree with related master file amounts, foot to the total in the account balance, and agree with the total in the general ledger is the detail tie-in objective.

A) True

B) False

Answer: A

Terms: Detail tie-in objective; General balance-related objective

Diff: Moderate

Objective: LO 6-8

AACSB: Reflective thinking skills

13) The cutoff objective, "transactions near the balance sheet date are recorded in the proper period," is a balance-related audit objective.

A) True

B) False

Answer: A

Terms: Cutoff objective; Balance-related audit objective

Diff: Moderate

Objective: LO 6-8

AACSB: Reflective thinking skills

Learning Objective 6-9

1) There are no questions for this Learning Objective.

Answer:

Learning Objective 6-10

1) Tests of details of balances are specific audit procedures that are intended to:

- A) test for monetary errors in the financial statements.
- B) prove that the accounts with material balances are classified correctly.
- C) prove that the trial balance is in balance.
- D) identify the details of the internal control system.

Answer: A

Terms: Tests of details balances; Specific audit procedures

Diff: Easy

Objective: LO 6-10

AACSB: Reflective thinking skills

2) Which of the following statements is not correct?

- A) There are many ways an auditor can accumulate evidence to meet overall audit objectives.
- B) Sufficient appropriate evidence must be accumulated to meet the auditor's professional responsibility.
- C) It is appropriate to minimize the cost of accumulating evidence.
- D) Gathering evidence and minimizing costs are equally important considerations that affect the approach the auditor selects.

Answer: D

Terms: Considerations for accumulating evidence

Diff: Moderate

Objective: LO 6-10

AACSB: Reflective thinking skills

3) Two overriding considerations affect the many ways an auditor can accumulate evidence:

- 1. Sufficient appropriate evidence must be accumulated to meet the auditor's professional responsibility.
- 2. Cost of accumulating evidence should be minimized.

In evaluating these considerations:

- A) the first is more important than the second.
- B) the second is more important than the first.
- C) they are equally important.
- D) it is impossible to prioritize them.

Answer: A

Terms: Considerations for accumulating evidence

Diff: Moderate

Objective: LO 6-10

AACSB: Reflective thinking skills

4) If the auditor has obtained a reasonable level of assurance about the fair presentation of the financial statements through understanding internal control, assessing control risk, testing controls, and analytical procedures, then the auditor:

- A) can issue an unqualified opinion.
- B) can significantly reduce other substantive tests.
- C) can write the engagement letter.
- D) needs to perform additional tests of controls so that the assurance level can be increased.

Answer: B

Terms: Auditor obtained reasonable level of assurance about fair presentation

Diff: Moderate

Objective: LO 6-10

AACSB: Reflective thinking skills

5) After the auditor has completed all audit procedures, it is necessary to combine the information obtained to reach an overall conclusion as to whether the financial statements are fairly presented. This is a highly subjective process that relies heavily on:

- A) generally accepted auditing standards.
- B) the AICPA's Code of Professional Conduct.
- C) generally accepted accounting principles.
- D) the auditor's professional judgment.

Answer: D

Terms: After auditor completed all audit procedures

Diff: Moderate

Objective: LO 6-10

AACSB: Reflective thinking skills

6) List the four phases of a Financial Statement Audit

Answer:

1. Plan and design an audit approach
2. Perform tests of controls and substantive tests of transactions
3. Perform analytical procedures and tests of details of balances
4. Complete the audit and issue the report

Terms: Phases of financial statement audit

Diff: Moderate

Objective: LO 6-10

AACSB: Reflective thinking skills

7) Describe what analytical procedures and tests of details of balances are and give an example of each.

Answer: Analytical procedures use comparisons and relationships to assess whether account balances and other data appear reasonable. For example, examine sales transactions in the sales journal for unusually large amounts and/or compare monthly sales with prior years.

Tests of details of balances are specific procedures intended to test for monetary misstatements in balances of accounts in the financial statements. For example, direct written communication with the client's customers to identify any incorrect amounts.

Terms: Analytical procedures and tests of balances

Diff: Challenging

Objective: LO 6-10

AACSB: Reflective thinking skills

8) Match seven of the terms (a-k) with the definitions provided below (1-7):

- a. Tests of details of balances
- b. Tests of controls
- c. Substantive tests of transactions
- d. Analytical procedures
- e. Transaction-related audit objectives
- f. Management assertions
- g. Balance-related audit objectives
- h. Fraud
- i. Illegal act
- j. Error
- k. Management fraud

_____ 1. An intentional misstatement of the financial statements.

_____ 2. A set of six audit objectives the auditor must meet, including timing, posting and summarization, and accuracy.

_____ 3. Implied or expressed representations made by the client about classes of transactions, account balances and disclosures in the financial statements.

_____ 4. Audit procedures testing for monetary misstatements to determine whether the balance-related audit objectives have been satisfied for each significant account balance.

_____ 5. A set of nine audit objectives the auditor must meet, including completeness, detail tie-in, and rights and obligations.

_____ 6. Audit procedures designed to test the effectiveness of control policies and procedures.

_____ 7. Use of comparisons and relationships to assess whether account balances or other data appears reasonable.

Answer:

- 1. h
- 2. e
- 3. f
- 4. a
- 5. g
- 6. b
- 7. d

Terms: Tests of balances; Tests of controls; Substantive tests of transactions; Analytical procedures; Management assertions; Balance-related audit objectives; Fraud

Diff: Moderate

Objective: LO 6-3, LO 6-6, LO 6-7, LO 6-8, and LO 6-10

AACSB: Reflective thinking skills

9) When an auditor has reduced assessed control risk based on tests of controls, he or she may then reduce the extent to which the accuracy of the financial statement information directly related to those controls must be supported through the accumulation of evidence using substantive tests.

A) True

B) False

Answer: A

Terms: Tests of controls; Assessed control risk

Diff: Easy

Objective: LO 6-10

AACSB: Reflective thinking skills

10) For a private company audit, tests of controls are normally performed only on those internal controls the auditor believes have not been operating effectively during the period under audit.

A) True

B) False

Answer: B

Terms: Tests of controls

Diff: Moderate

Objective: LO 6-10

AACSB: Reflective thinking skills