

Auditing and Assurance Services, 14e (Arens)
Chapter 7 Audit Evidence

Learning Objective 7-1

1) There are no questions for this Learning Objective.
Answer:

Learning Objective 7-2

1) Auditors must make decisions regarding what evidence to gather and how much to accumulate. Which of the following is a decision that must be made by auditors related to evidence?

A)

| Sample size | Timing of audit procedures |
|-------------|----------------------------|
| Yes | Yes |

B)

| Sample size | Timing of audit procedures |
|-------------|----------------------------|
| No | No |

C)

| Sample size | Timing of audit procedures |
|-------------|----------------------------|
| Yes | No |

D)

| Sample size | Timing of audit procedures |
|-------------|----------------------------|
| No | Yes |

Answer: C

Terms: Decision to be made by auditors related to evidence

Diff: Easy

Objective: LO 7-2

AACSB: Reflective thinking skills

2) Audit procedures are concerned with the nature, extent, and timing in gathering audit evidence. Which, of the following, is true as to the timing of audit procedures?

A)

| | |
|--|---|
| Prior to the fiscal year-end of the client | Subsequent to the fiscal year-end of the client |
| Yes | Yes |

B)

| | |
|--|---|
| Prior to the fiscal year-end of the client | Subsequent to the fiscal year-end of the client |
| No | No |

C)

| | |
|--|---|
| Prior to the fiscal year-end of the client | Subsequent to the fiscal year-end of the client |
| Yes | No |

D)

| | |
|--|---|
| Prior to the fiscal year-end of the client | Subsequent to the fiscal year-end of the client |
| No | Yes |

Answer: A

Terms: Timing of audit procedures

Diff: Easy

Objective: LO 7-2

AACSB: Reflective thinking skills

Learning Objective 7-3

1) Audit evidence has two primary qualities for the auditor; relevance and reliability. Given the choices below which provides the auditor with the most reliable audit evidence?

A) general ledger account balances

B) confirmation of accounts receivable balance received from a customer

C) internal memo explaining the issuance of a credit memo

D) copy of month-end adjusting entries

Answer: B

Terms: Audit evidence qualities of relevance and reliability

Diff: Easy

Objective: LO 7-3

AACSB: Analytic skills

2) Which of the following is not a characteristic of the reliability of evidence?

- A) effectiveness of client internal controls
- B) education of auditor
- C) independence of information provider
- D) timeliness

Answer: B

Terms: Characteristic of reliability of evidenc

Diff: Easy

Objective: LO 7-3

AACSB: Reflective thinking skills

3) The auditor must gather sufficient and appropriate evidence during the course of the audit. Sufficient evidence must:

- A) be well documented and cross-referenced in the audit documents.
- B) be based on sources that are external to company.
- C) provide evidence that prove or disprove an audit objective/assertion.
- D) be persuasive enough to enable the auditor to issue an audit report.

Answer: D

Terms: Sufficient evidence

Diff: Easy

Objective: LO 7-3

AACSB: Reflective thinking skills

4) Audit evidence obtained directly by the auditor will not be reliable if:

- A) the auditor lacks the competence to evaluate the evidence.
- B) it is provided by the client's attorney.
- C) the client denies its veracity.
- D) it is impossible for the auditor to obtain additional corroboratory evidence.

Answer: A

Terms: Audit evidence obtained directly by auditor

Diff: Easy

Objective: LO 7-3

AACSB: Reflective thinking skills

5) Appropriateness of evidence is a measure of the:

- A) quantity of evidence.
- B) quality of evidence.
- C) sufficiency of evidence.
- D) meaning of evidence.

Answer: B

Terms: Appropriateness of evidence

Diff: Easy

Objective: LO 7-3

AACSB: Reflective thinking skills

6) Which of the following statements regarding the relevance of evidence is correct?

- A) To be relevant, evidence must pertain to the audit objective of the evidence.
- B) To be relevant, evidence must be persuasive.
- C) To be relevant, evidence must relate to multiple audit objectives.
- D) To be relevant, evidence must be derived from a system including effective internal controls.

Answer: A

Terms: Relevance of evidence

Diff: Easy

Objective: LO 7-3

AACSB: Reflective thinking skills

7) Two determinants of the persuasiveness of evidence are:

- A) competence and sufficiency.
- B) relevance and reliability.
- C) appropriateness and sufficiency.
- D) independence and effectiveness.

Answer: C

Terms: Determinants of persuasiveness of evidence

Diff: Easy

Objective: LO 7-3

AACSB: Reflective thinking skills

8) The two characteristics of the appropriateness of evidence are:

- A) relevance and timeliness.
- B) relevance and accuracy.
- C) relevance and reliability.
- D) reliability and accuracy.

Answer: C

Terms: Appropriateness of evidence

Diff: Easy

Objective: LO 7-3

AACSB: Reflective thinking skills

9) Which of the following forms of evidence would be least persuasive in forming the auditor's opinion about marketable securities and other investments held by the company?

- A) Responses to auditor's questions by the president and controller regarding the investments account.
- B) Correspondence with a stockbroker regarding the quantity of client's investments held in street name by the broker.
- C) Minutes of the board of directors authorizing the purchase of stock as an investment.
- D) The auditor's count of marketable securities.

Answer: A

Terms: Least persuasive form of evidence

Diff: Moderate

Objective: LO 7-3

AACSB: Reflective thinking skills

10) Which of the following statements is not correct?

- A) It is possible to vary the sample size from one unit to 100% of the items in the population.
- B) The decision of how many items to test should not be influenced by the increased costs of performing the additional tests.
- C) The decision of how many items to test must be made by the auditor for each audit procedure.
- D) The sample size for any given procedure is likely to vary from audit to audit.

Answer: B

Terms: Testing of items; Sample size

Diff: Moderate

Objective: LO 7-3

AACSB: Reflective thinking skills

11) For audit evidence to be compelling to the auditor it must be sufficient and appropriate. Which statement below is not correct regarding the appropriateness of audit evidence?

- A) The more effective the internal control system, the more assurance it provides the auditor about the reliability of financial reporting by the client.
- B) An auditor's opinion, to be economically useful and profitable to the auditing firm needs to be formed within a reasonable time and based on evidence obtained that assures profits for the auditing firm.
- C) Evidence obtained from independent sources outside the entity is generally more reliable than evidence secured solely within the entity.
- D) The independent auditor's direct personal knowledge, obtained through inquiry, observation and inspection, is generally more persuasive than information obtained indirectly.

Answer: B

Terms: Appropriateness of audit evidence

Diff: Moderate

Objective: LO 7-3

AACSB: Reflective thinking skills

12) Which one of the following is not one of the primary purposes of audit documentation prepared by the audit team?

- A) A basis for planning the audit.
- B) A record of the evidence accumulated and the results of the tests.
- C) A basis for review by supervisors and partners.
- D) A basis for determining work deficiencies by peer review teams.

Answer: D

Terms: Purposes of audit documentation

Diff: Moderate

Objective: LO 7-3

AACSB: Reflective thinking skills

13) Which of the following is the most objective type of evidence?

- A) A letter written by the client's attorney discussing the likely outcome of outstanding lawsuits.
- B) The physical count of securities and cash.
- C) Inquiries of the credit manager about the collectability of noncurrent accounts receivable.
- D) Observation of cobwebs on some inventory bins.

Answer: B

Terms: Most objective type of evidence

Diff: Moderate

Objective: LO 7-3

AACSB: Reflective thinking skills

14) Due professional care, the third general standard, is concerned with what is done by the independent auditor and how well it is done. For example, due care in the matter of audit documentation requires that audit documentation of the evidence gathered by the auditor meets which of the following criteria?

- A) Workpapers be indexed to the general ledger accounts and include both a permanent file and a general file.
- B) The content be sufficient to provide support for the auditor's opinion, including the auditor's representation as to compliance with auditing standards.
- C) Audit evidence is principally gathered to determine if the client's financial statements, as prepared by management, can be relied upon to make managerial decisions about the firm.
- D) Audit evidence as displayed in the workpapers is primarily performed to protect the auditing firm in the case of a lawsuit by investors.

Answer: B

Terms: Audit evidence gathered by auditors meets which criteria

Diff: Moderate

Objective: LO 7-3

AACSB: Reflective thinking skills

15) Which items affect the sufficiency of evidence when choosing a sample?

A)

| | |
|--|--------------------------------------|
| Selecting items with a high likelihood of misstatement | The randomness of the items selected |
| Yes | Yes |

B)

| | |
|--|--------------------------------------|
| Selecting items with a high likelihood of misstatement | The randomness of the items selected |
| No | No |

C)

| | |
|--|--------------------------------------|
| Selecting items with a high likelihood of misstatement | The randomness of the items selected |
| Yes | No |

D)

| | |
|--|--------------------------------------|
| Selecting items with a high likelihood of misstatement | The randomness of the items selected |
| No | Yes |

Answer: C

Terms: Sufficiency of evidence when choosing a sample

Diff: Moderate

Objective: LO 7-3

AACSB: Reflective thinking skills

16) Determine which of the following is most correct regarding the reliability of audit evidence.

A) Information that is indirectly obtained from external sources is the most reliable audit evidence.

B) Reliability of audit evidence is dependent upon the evidence being convincing.

C) Reliability of evidence refers to the amount of evidence obtained.

D) An effective internal control system provides more reliable audit evidence.

Answer: D

Terms: Reliability of audit evidence

Diff: Moderate

Objective: LO 7-3

AACSB: Reflective thinking skills

17) Evidence is generally considered appropriate when:

A) it has been obtained by random selection.

B) there is enough of it to afford a reasonable basis for an opinion on financial statements.

C) it has the qualities of being relevant, objective, and free from known bias.

D) it consists of written statements made by managers of the enterprise under audit.

Answer: C

Terms: Evidence considered appropriate

Diff: Moderate

Objective: LO 7-3

AACSB: Reflective thinking skills

18) Given the economic and time constraints in which auditors can collect evidence about management assertions about the financial statements, the auditor normally gathers evidence that is:

- A) irrefutable.
- B) conclusive.
- C) persuasive.
- D) completely convincing.

Answer: C

Terms: Auditor normally gathers evidence that is

Diff: Moderate

Objective: LO 7-3

AACSB: Reflective thinking skills

19) Which of the following statements is **not** a correct use of the terminology in relation to audit evidence?

- A) Evidence obtained from an independent source outside the client organization is more reliable than that obtained from within.
- B) Documentary evidence is more reliable when it is received by the auditor indirectly rather than directly.
- C) Documents that originate outside the company are considered more reliable than those that originate within the client's organization.
- D) External evidence, such as communications from banks, is generally regarded as more reliable than answers obtained from inquiries of the client.

Answer: B

Terms: Terminology related to audit evidence

Diff: Challenging

Objective: LO 7-3

AACSB: Reflective thinking skills

20) Evidence is usually more persuasive for balance sheet accounts when it is obtained:

- A) as close to the balance sheet date as possible.
- B) only from transactions occurring on the balance sheet date.
- C) from various times throughout the client's year.
- D) from the time period when transactions in that account were most numerous during the fiscal period.

Answer: A

Terms: Evidence is more persuasive for balance sheet accounts

Diff: Challenging

Objective: LO 7-3

AACSB: Reflective thinking skills

21) Which of the following statements is true?

- A) A large sample of highly competent evidence is persuasive if it is relevant to the objective being tested.
- B) A large sample of evidence that is neither competent nor timely is not persuasive.
- C) A small sample of only one or two pieces of relevant, competent, and timely evidence lacks persuasiveness.
- D) The persuasiveness of evidence can be evaluated after considering its sufficiency.

Answer: A

Terms: Samples and evidence

Diff: Challenging

Objective: LO 7-3

AACSB: Reflective thinking skills

22) Which of the following statements relating to the competence of evidential matter is always true?

- A) Evidence from outside an enterprise is always reliable.
- B) Accounting data developed under satisfactory conditions of internal control are more relevant than data developed under unsatisfactory internal control conditions.
- C) Oral representations made by management are not reliable evidence.
- D) Evidence must be both reliable and relevant to be considered appropriate.

Answer: D

Terms: Competence of evidential matter

Diff: Challenging

Objective: LO 7-3

AACSB: Reflective thinking skills

23) Distinguish between internal documentation and external documentation as types of audit evidence. Give two examples of each. Which type is considered more reliable?

Answer: Internal documentation involves the auditor's examination of documents that have been prepared and used within the client's organization and are retained without ever going to an outside party. Examples would include duplicate sales invoices, employees' time reports, and inventory receiving reports.

External documentation involves the auditor's examination of documents that have been in the hands of someone outside the client's organization. Examples include vendors' invoices, cancelled checks, cancelled notes payable, and insurance policies.

External documents are regarded as more reliable evidence than internal documents.

Terms: Internal and external documentation; Reliability of evidence

Diff: Moderate

Objective: LO 7-3

AACSB: Reflective thinking skills

24) Discuss three of the following influences on the persuasiveness of evidence.

1. Relevance
2. Independence of provider
3. Effectiveness of client's internal controls
4. Auditor's direct knowledge
5. Degree of objectivity
6. Timeliness

Answer:

1. Relevance — Evidence must pertain to the audit objective if it is to be persuasive. Relevance must be considered in terms of specific audit objectives as evidence may be relevant to one objective and not another.
2. Independence of provider — Evidence obtained from a source outside the entity is more reliable and persuasive than that obtained from within.
3. Effectiveness of client's internal controls — When a client's internal controls are effective, evidence obtained is more reliable than when they are weak.
4. Auditor's direct knowledge — Evidence obtained directly by the auditor through physical examination, observation, computation and inspection is more competent than information obtained indirectly.
5. Degree of objectivity — Objective evidence is more reliable than evidence that requires considerable judgment to determine whether it is correct.
6. Timeliness — The timeliness of audit evidence can refer either to when it is accumulated or to the period covered by the audit. Evidence is usually more reliable for balance sheet accounts when it is obtained as close to the balance sheet date as possible.

Terms: Influences persuasiveness of evidence

Diff: Moderate

Objective: LO 7-3

AACSB: Reflective thinking skills

25) Why is the appropriateness of audit evidence obtained by the auditor important in forming an audit opinion? Describe the qualities information should have to be considered appropriate by the auditor.

Answer: Appropriateness is a measure of the quality of evidence. Audit evidence that is considered appropriate contains the characteristics of relevance and reliability. Relevant evidence related to the assertion being tested. Reliability refers to the relative "truthfulness" of the assertion/objective.

Terms: Appropriateness of audit evidence

Diff: Moderate

Objective: LO 7-3

AACSB: Reflective thinking skills

26) The reliability of evidence refers to the degree to which evidence is considered believable or trustworthy. There are six factors that affect the reliability of audit evidence. One factor is the independence of the provider; i.e., evidence obtained from a source outside the client company is more reliable than that obtained within. Identify and discuss any two of the remaining five factors:

Answer: The remaining four factors that affect the reliability of evidence are:

- *Effectiveness of client's internal control.* When a client's internal controls are effective, evidence obtained from the client is more reliable than when controls are weak.
- *Auditor's direct knowledge.* Evidence obtained directly by the auditor is more reliable than information obtained indirectly.
- *Qualifications of individuals providing the information.* Information obtained from persons not familiar with the business world would generally not be considered as reliable as information from an expert in a business-related field.
- *Degree of objectivity.* Objective evidence is more reliable than evidence that requires considerable judgment to determine whether it is correct.
- *Timeliness* — The timeliness of audit evidence can refer either to when it is accumulated or to the period covered by the audit. Evidence is usually more reliable for balance sheet accounts when it is obtained as close to the balance sheet date as possible.

Terms: Reliability of evidence

Diff: Challenging

Objective: LO 7-3

AACSB: Reflective thinking skills

27) Below are 10 documents typically examined during an audit. Classify each document as either internal or external.

| Type of Document | Documents |
|------------------|--|
| | 1. Canceled checks for payments of accounts payable. |
| | 2. Payroll time cards. |
| | 3. Duplicate sales invoices. |
| | 4. Vendors' invoices. |
| | 5. Bank statements. |
| | 6. Minutes of the board of directors' meetings. |
| | 7. Signed lease agreements. |
| | 8. Notes receivable. |
| | 9. Subsidiary accounts receivable records. |
| | 10. Remittance advices. |

Answer:

- | | |
|-------------|--------------|
| 1. External | 6. Internal |
| 2. Internal | 7. External |
| 3. Internal | 8. External |
| 4. External | 9. Internal |
| 5. External | 10. External |

Terms: Internal and external evidence

Diff: Moderate

Objective: LO 7-3

AACSB: Analytic skills

28) Audit evidence to support an opinion about the fairness of a client's financial statements consists entirely of written information.

A) True

B) False

Answer: B

Terms: Audit evidence to support an opinion

Diff: Easy

Objective: LO 7-3

AACSB: Reflective thinking skills

29) The relevance of audit evidence depends on the audit objective being tested.

A) True

B) False

Answer: A

Terms: Relevance of audit evidence

Diff: Easy

Objective: LO 7-3

AACSB: Reflective thinking skills

30) Inquiries of the client are usually sufficient to provide appropriate evidence to satisfy an audit objective.

A) True

B) False

Answer: B

Terms: Inquiries of client; Appropriate evidence

Diff: Easy

Objective: LO 7-3

AACSB: Reflective thinking skills

31) A canceled check written by the client, made payable to a local supplier and drawn on the client's bank account is one type of internal document.

A) True

B) False

Answer: B

Terms: Internal document

Diff: Easy

Objective: LO 7-3

AACSB: Reflective thinking skills

32) Objective evidence is more reliable, and hence more persuasive, than subjective evidence.

A) True

B) False

Answer: A

Terms: Objective evidence more reliable

Diff: Moderate

Objective: LO 7-3

AACSB: Reflective thinking skills

33) Relevance of evidence can only be considered in terms of specific audit objectives.

A) True

B) False

Answer: A

Terms: Relevance of evidence

Diff: Moderate

Objective: LO 7-3

AACSB: Reflective thinking skills

Learning Objective 7-4

1) Calculating the gross margin for the current year under audit as a percent of sales and comparing it with previous years is what type of evidence?

A) physical examination

B) analytical procedures

C) observation

D) inquiry

Answer: B

Terms: Calculate and compare gross margin

Diff: Easy

Objective: LO 7-4

AACSB: Reflective thinking skills

2) When the auditor develops supporting evidence for amounts posted to account balances with documentary evidence, that process is called:

A) inquiry.

B) confirmation.

C) vouching.

D) physical examination.

Answer: C

Terms: Auditor develops supporting evidence for amounts posted with documentary evidence

Diff: Easy

Objective: LO 7-4

AACSB: Reflective thinking skills

3) An example of an external document that provides reliable information for the auditor is:

A) employees' time reports.

B) bank statements.

C) purchase order for company purchases.

D) carbon copies of checks.

Answer: B

Terms: External document

Diff: Easy

Objective: LO 7-4

AACSB: Reflective thinking skills

4) An example of a document the auditor receives from the client, but which was prepared by someone outside the client's organization, is a:

- A) confirmation.
- B) sales invoice.
- C) vendor invoice.
- D) bank reconciliation.

Answer: C

Terms: Example of document auditor receives from client but prepared by outside source

Diff: Easy

Objective: LO 7-4

AACSB: Reflective thinking skills

5) "The use of comparisons and relationships to assess whether account balances or other data appear reasonable compared to the auditor's expectations" is a definition of:

- A) analytical procedures.
- B) tests of transactions.
- C) tests of balances.
- D) auditing.

Answer: A

Terms: Use of comparisons and relationships to assess whether account balances

Diff: Easy

Objective: LO 7-4

AACSB: Reflective thinking skills

6) Often, auditor procedures result in significant differences being discovered by the auditor. The auditor should investigate further if:

A)

| | |
|---|---|
| Significant differences are not expected but do exist | Significant differences are expected but do not exist |
| Yes | Yes |

B)

| | |
|---|---|
| Significant differences are not expected but do exist | Significant differences are expected but do not exist |
| No | No |

C)

| | |
|---|---|
| Significant differences are not expected but do exist | Significant differences are expected but do not exist |
| Yes | No |

D)

| | |
|---|---|
| Significant differences are not expected but do exist | Significant differences are expected but do not exist |
| No | Yes |

Answer: A

Terms: Audit procedures result in significant differences

Diff: Easy

Objective: LO 7-4

AACSB: Reflective thinking skills

7) When the auditor uses tracing as an audit procedure for tests of transactions she is primarily concerned with which audit objective?

A) Occurrence

B) Completeness

C) Cutoff

D) Classification

Answer: A

Terms: Tracing as an audit procedure concerned with audit objective

Diff: Moderate

Objective: LO 7-4

AACSB: Reflective thinking skills

8) When the auditor used the audit procedure vouching she is primarily concerned with which of the following audit objectives when testing classes of transactions?

- A) Occurrence
- B) Completeness
- C) Authorization
- D) Classification

Answer: B

Terms: Vouching as an audit procedure concerned with audit objective

Diff: Moderate

Objective: LO 7-4

AACSB: Reflective thinking skills

9) When auditors use documentation to support recorded transactions and amounts, the process is usually called:

- A) tracing.
- B) confirmations.
- C) vouching.
- D) reperformance.

Answer: C

Terms: Directional testing

Diff: Moderate

Objective: LO 7-4

AACSB: Reflective thinking skills

10) Analytical procedures must be used during which phase(s) of the audit?

A)

| Test of Controls | Planning | Completion |
|------------------|----------|------------|
| Yes | Yes | Yes |

B)

| Test of Controls | Planning | Completion |
|------------------|----------|------------|
| No | Yes | Yes |

C)

| Test of Controls | Planning | Completion |
|------------------|----------|------------|
| Yes | No | No |

D)

| Test of Controls | Planning | Completion |
|------------------|----------|------------|
| No | No | No |

Answer: B

Terms: Analytical procedures use during phases of the audit

Diff: Moderate

Objective: LO 7-4

AACSB: Analytic skills

11) Auditors may decide to replace tests of details with analytical procedures when possible because the:

- A) analytical procedures are more reliable.
- B) analytical procedures are considerably less expensive.
- C) analytical procedures are more persuasive.
- D) tests of details are more difficult to interpret.

Answer: B

Terms: Tests of details of balances; Substantive analytical procedures

Diff: Moderate

Objective: LO 7-4

AACSB: Reflective thinking skills

12) When making decisions about evidence for a given audit, the auditor's goal is to obtain a sufficient amount of timely, reliable evidence that is relevant to the information being verified. In addition, the goal of audit efficiency is to gather and evaluate the information:

- A) no matter the cost involved in obtaining such evidence.
- B) even if cost is irrelevant to the auditor, because they bill the client for costs incurred.
- C) at the lowest possible total cost.
- D) at the cost suggested in the engagement letter.

Answer: C

Terms: Goal of audit efficiency

Diff: Moderate

Objective: LO 7-4

AACSB: Reflective thinking skills

13) "Physical examination" is the inspection or count by the auditor of items such as:

- A) cash, inventory, and payroll timecards.
- B) cash, inventory, canceled checks, and sales documents.
- C) cash, inventory, canceled checks, and tangible fixed assets.
- D) cash, inventory, securities, notes receivable, and tangible fixed assets.

Answer: D

Terms: Physical examination

Diff: Moderate

Objective: LO 7-4

AACSB: Reflective thinking skills

14) Which of the following statements is most correct regarding the primary purpose of audit procedures?

- A) to detect all errors or fraudulent activities as well as illegal activities
- B) to comply with auditing standards promulgated by the PCAOB for publicly held clients
- C) to gather corroborative audit evidence about management's assertions regarding the client's financial statements
- D) to determine the amount of errors in the balance sheet accounts in order to adjust the accounts to actual

Answer: C

Terms: Primary purpose of audit procedures

Diff: Moderate

Objective: LO 7-4

AACSB: Reflective thinking skills

15) Given the audit procedures below, which one provides the most reliable evidence?

- A) Confirmations
- B) Recalculation
- C) Reperformance
- D) Observations

Answer: A

Terms: Audit procedure that provides most reliable evidence

Diff: Moderate

Objective: LO 7-4

AACSB: Reflective thinking skills

16) Confirmations would almost always be used, assuming all the accounts below are material, for:

- A) individual transactions between organizations, such as sales transactions.
- B) bank balances and accounts receivable.
- C) fixed asset additions.
- D) payroll expenses.

Answer: B

Terms: Confirmations

Diff: Moderate

Objective: LO 7-4

AACSB: Reflective thinking skills

17) To be considered reliable evidence, confirmations must be controlled by:

- A) a client employee responsible for accounts receivable.
- B) a financial statement auditor.
- C) a client's internal audit department.
- D) a client's controller or CFO.

Answer: B

Terms: Confirmations controlled to be considered reliable evidence

Diff: Moderate

Objective: LO 7-4

AACSB: Reflective thinking skills

18) Indicate whether confirmation of accounts receivable and accounts payable, provided they each are significant accounts, is required or optional:

A)

| Accounts Receivable | Accounts Payable |
|---------------------|------------------|
| Required | Required |

B)

| Accounts Receivable | Accounts Payable |
|---------------------|------------------|
| Required | Optional |

C)

| Accounts Receivable | Accounts Payable |
|---------------------|------------------|
| Optional | Required |

D)

| Accounts Receivable | Accounts Payable |
|---------------------|------------------|
| Optional | Optional |

Answer: B

Terms: Confirmation of accounts receivable and accounts payable

Diff: Moderate

Objective: LO 7-4

AACSB: Reflective thinking skills

19) The Auditing Standards Board has concluded that analytical procedures are so important that they are required during:

- A) planning and test of control phases.
- B) planning and completion phases.
- C) test of control and completion phases.
- D) planning, test of control, and completion phases.

Answer: B

Terms: Analytical procedures required

Diff: Moderate

Objective: LO 7-4

AACSB: Reflective thinking skills

20) A benefit obtained from comparing the client's data with industry averages is that it provides a(n):

- A) benchmark to compare the company against industry averages.
- B) indication where errors exist in the statements.
- C) benchmark to be used in evaluating a client's budgets.
- D) comparison of "what is" with "what should be."

Answer: A

Terms: Comparing client data with industry averages

Diff: Moderate

Objective: LO 7-4

AACSB: Reflective thinking skills

21) The primary purpose of performing analytical procedures in the planning phase of an audit is to:

- A) help the auditor obtain an understanding of the client's industry and business.
- B) assess the going concern assumption.
- C) indicate possible misstatements.
- D) reduce detailed tests.

Answer: A

Terms: Primary purpose of analytical procedures in planning phase of audit

Diff: Moderate

Objective: LO 7-4

AACSB: Reflective thinking skills

22) Which of the following is not a correct combination of terms and related type of audit evidence?

- A) Inquire inquiries of client
- B) Count physical examination
- C) Recompute documentation
- D) Read documentation

Answer: C

Terms: Combination of terms and related audit evidence

Diff: Moderate

Objective: LO 7-4

AACSB: Reflective thinking skills

23) Which of the following is not one of the major types of analytical procedures?

- A) compare client with industry averages
- B) compare client with prior year
- C) compare client with budget
- D) compare client with SEC averages

Answer: D

Terms: Major type of analytical procedures

Diff: Moderate

Objective: LO 7-4

AACSB: Reflective thinking skills

24) An important benefit of industry comparisons is as:

- A) an aid to understanding the client's business.
- B) an indicator of errors.
- C) an indicator of fraud.
- D) a least-cost indicator for audit procedures.

Answer: A

Terms: Benefit of industry comparisons

Diff: Moderate

Objective: LO 7-4

AACSB: Reflective thinking skills

25) The auditor is concerned that a client is failing to bill customers for shipments. An audit procedure that would gather relevant evidence would be to:

- A) select a sample of duplicate sales invoices and trace each to related shipping documents.
- B) trace a sample of shipping documents to related duplicate sales invoices.
- C) trace a sample of Sales Journal entries to the Accounts Receivable subsidiary ledger.
- D) compare the total of the Schedule of Accounts Receivable with the balance of the Accounts Receivable account in the general ledger.

Answer: B

Terms: Audit procedure to gather relevant evidence that client fails to bill

Diff: Challenging

Objective: LO 7-4

AACSB: Analytic skills

26) In performing your audit for a privately-held firm your inquiries have yielded that one of the company's owner's primary motivations is to pay the least amount of income tax that is possible. Based on this observation which audit objective for ending inventory would the auditor be most concerned about ascertaining?

- A) Completeness
- B) Accuracy
- C) Rights and obligations
- D) Existence

Answer: A

Terms: Audit objective for ending inventory

Diff: Challenging

Objective: LO 7-4

AACSB: Analytic skills

27) Which of the following statements is not correct?

- A) Analytical procedures are used to isolate accounts or transactions that should be investigated more extensively.
- B) For certain immaterial accounts, analytical procedures may be the only evidence needed.
- C) In some instances, other types of evidence may be reduced when analytical procedures indicate that an account balance appears reasonable.
- D) Analytical procedures use supporting documentation to determine which account balances need additional detailed procedures.

Answer: D

Terms: Analytical procedures

Diff: Challenging

Objective: LO 7-4

AACSB: Reflective thinking skills

28) You are auditing the company's purchasing process for goods and services. You are primarily concerned with the company not recording all purchase transactions. Which audit procedure below would be the most effective audit procedure in this case?

- A) Vouching from the accounts payable account to the vendor invoices.
- B) Tracing vendor invoices to recorded amounts in the accounts payable account.
- C) Confirmation accounts payable recorded amounts.
- D) Reconciling the accounts payable subsidiary ledger to the accounts payable account.

Answer: B

Terms: Audit procedure for recording all purchase transactions

Diff: Challenging

Objective: LO 7-4

AACSB: Analytic skills

29) Which of the following discoveries through the use of analytical procedures would most likely indicate a relatively high risk of financial failure?

- A) A decline in gross margin percentages.
- B) An increase in the balance in fixed assets.
- C) An increase in the ratio of allowance for uncollectible accounts to gross accounts receivable, while at the same time accounts receivable turnover also decreased.
- D) A higher than normal ratio of long-term debt to net worth as well as a lower than average ratio of profits to total assets.

Answer: D

Terms: Analytical procedures

Diff: Challenging

Objective: LO 7-4

AACSB: Analytic skills

30) Which of the following statements is correct regarding the costs involved in obtaining evidence?

A)

| | |
|--|--|
| Physical examination is usually the least expensive type of audit evidence | Cost of obtaining evidence may be a factor in deciding whether to obtain that evidence |
| Yes | Yes |

B)

| | |
|--|--|
| Physical examination is usually the least expensive type of audit evidence | Cost of obtaining evidence may be a factor in deciding whether to obtain that evidence |
| No | No |

C)

| | |
|--|--|
| Physical examination is usually the least expensive type of audit evidence | Cost of obtaining evidence may be a factor in deciding whether to obtain that evidence |
| Yes | No |

D)

| | |
|--|--|
| Physical examination is usually the least expensive type of audit evidence | Cost of obtaining evidence may be a factor in deciding whether to obtain that evidence |
| No | Yes |

Answer: D

Terms: Costs in obtaining evidence

Diff: Challenging

Objective: LO 7-4

AACSB: Reflective thinking skills

31) An analytical procedure used to test the reasonableness of an account balance occurs when the auditor calculates the expected balance and compares it with the actual balance. The auditor's expected account balance may be determined by:

A) using industry standards.

B) using Dun and Bradstreet reports.

C) relating it to another account that involves financial statement articulation.

D) inquiry of the client.

Answer: C

Terms: Analytical procedure used to test reasonableness of an account balance

Diff: Challenging

Objective: LO 7-4

AACSB: Reflective thinking skills

32) One purpose of performing analytical procedures in the planning phase of an audit is to assess the client's financial condition. Explain how the assessment of a client's financial condition can affect the auditor's decisions concerning evidence accumulation in later phases of the audit.

Answer: The use of analytical procedures is often a useful indicator for determining whether the client company has financial problems and if substantial doubt exists about the entity's ability to continue as a going concern. The analytical procedures could also indicate the presence of possible misstatements in the financial statements if significant unexpected fluctuations occur. These items may warrant increased audit procedures, whereas when the analytical procedures reveal no unusual fluctuations, the possibility of material misstatement is minimized and it is possible, thus, to perform fewer detailed tests on related accounts or to eliminate certain audit procedures, reduce sample sizes, or to move the procedures farther away from the balance sheet date.

Terms: Analytical procedures

Diff: Moderate

Objective: LO 7-4

AACSB: Reflective thinking skills

33) There are four important purposes of analytical procedures. Identify three of these four purposes and, for each purpose, give a specific example of an analytical procedure that an auditor might perform.

Answer: Four important purposes of analytical procedures are:

- To help the auditor understand the client's industry and business, the auditor might analyze recent trends in the client's gross margin percentages to assess the effects of competition in the industry.
- To aid in the assessment of the client's ability to continue as a going concern, the auditor might analyze several of the client's key ratios including the ratio of long-term debt to net worth, the ratio of profits to total assets, and the current ratio.
- To indicate the presence of possible misstatements in the financial statements, the auditor might compare the current year's unaudited account balances with the previous year's audited balances.
- To reduce the extent of detailed tests, the auditor might perform a simple analytical procedure such as multiplying the client's monthly rent times 12 as a test of the client's rent expense account. If the product agrees with the balance in rent expense, no additional testing of the account may be necessary.

Terms: Purposes of analytical procedures

Diff: Challenging

Objective: LO 7-4

AACSB: Reflective thinking skills

34) Define the following terms commonly used in audit procedures:

1. Examine
2. Scan
3. Compute
4. Foot
5. Compare
6. Count
7. Vouch

Answer:

1. Examine — A reasonably detailed study of a specific document or record to determine specific facts about it. It is the inspection or count by the auditor of a tangible asset.
2. Scan — A less detailed examination of a document or record to determine whether there is something unusual warranting further investigation.
3. Compute — A calculation done by the auditor independent of the client.
4. Foot — Addition of a column of numbers to determine whether the total is the same as the client's.
5. Compare — A comparison of information in two different locations.
6. Count — A determination of assets on hand at a given time. This is associated with evidence defined as physical examination.
7. Vouch — The use of documents to verify recorded transactions or amounts.

Terms: Audit evidence and audit procedures

Diff: Moderate

Objective: LO 7-4

AACSB: Reflective thinking skills

35) Below are 12 audit procedures. Classify each procedure according to the following types of audit evidence: (1) physical examination, (2) confirmation, (3) documentation, (4) observation, (5) inquiry of the client, (6) reperformance, and (7) analytical procedure.

| Type of Evidence | Audit Procedures |
|------------------|---|
| | 1. Watch client employees count inventory to determine whether company procedures are being followed. |
| | 2. Count inventory items and record the amount in the audit files. |
| | 3. Trace postings from the sales journal to the general ledger accounts. |
| | 4. Calculate the ratio of cost of goods sold to sales as a test of overall reasonableness of gross margin relative to the preceding year. |
| | 5. Obtain information about the client's internal controls by asking questions of client personnel. |
| | 6. Trace column totals from the cash disbursements journal to the general ledger. |
| | 7. Examine a piece of equipment to make sure a recent purchase of equipment was actually received and is in operation. |
| | 8. Review the total of repairs and maintenance for each month to determine whether any month's total was unusually large. |
| | 9. Compare vendor names and amounts on purchase invoices with entries in the purchases journal. |
| | 10. Foot entries in the sales journal to determine whether they were correctly totaled by the client. |
| | 11. Make a surprise count of petty cash to verify that the amount of the petty cash fund is intact. |
| | 12. Obtain a written statement from the client's bank stating the client's year-end balance on deposit. |

Answer:

1. Observation
2. Physical examination
3. Reperformance
4. Analytical procedure
5. Inquiry of the client
6. Reperformance
7. Physical examination
8. Analytical procedure
9. Documentation
10. Reperformance
11. Physical examination
12. Confirmation

Terms: Audit evidence and related evidence

Diff: Moderate

Objective: LO 7-4

AACSB: Reflective thinking skills

36) Match nine of the terms (a-k) with the definitions provided below (1-9):

- a. Foot
- b. Compute
- c. Scan
- d. Inquire
- e. Count
- f. Trace
- g. Reperform
- h. Read
- i. Examine
- j. Observe
- k. Compare

- _____ 1. A calculation done by the auditor independent of the client.
- _____ 2. Addition of a column of numbers to determine if the total is the same as the client's.
- _____ 3. A comparison of information in two different locations.
- _____ 4. A use of the senses to assess certain activities.
- _____ 5. Following details of transactions from original documents to journals.
- _____ 6. A less detailed examination of a document or record to determine if there is something unusual warranting further investigation.
- _____ 7. Obtaining information from the client in response to specific questions.
- _____ 8. A determination of assets on hand at a given time.
- _____ 9. An examination of written information to determine facts pertinent to the audit.

Answer:

- 1. b
- 2. a
- 3. k
- 4. j
- 5. f
- 6. c
- 7. d
- 8. e
- 9. h

Terms: Audit procedures; Foot; Compute; Scan; Inquire; Count; Trace; Read; Observe; Compare

Diff: Moderate

Objective: LO 7-4

AACSB: Reflective thinking skills

37) Match five of the terms (a-h) with the definitions provided below (1-5):

- a. Audit documentation
- b. Audit procedures
- c. Audit objectives
- d. Analytical procedures
- e. Budgets
- f. Reliability of evidence
- g. Sufficiency of evidence
- h. Persuasiveness of evidence

_____ 1. Use of comparisons and relationships to assess the reasonableness of account balances.

_____ 2. Detailed instructions for the collection of a type of audit evidence.

_____ 3. The degree to which evidence can be considered believable or trustworthy.

_____ 4. Contains all the information that the auditor considers necessary to conduct an adequate audit and to provide support for the audit report.

_____ 5. This is determined by the amount of evidence obtained.

Answer:

- 1. d
- 2. b
- 3. f
- 4. a
- 5. g

Terms: Analytical procedures; Audit procedures; Reliability of evidence; Sufficiency of evidence

Diff: Moderate

Objective: LO 7-2, LO 7-3, and LO 7-4

AACSB: Reflective thinking skills

38) Confirmations are among the most expensive type of evidence to obtain.

A) True

B) False

Answer: A

Terms: Confirmations; Cost of evidence

Diff: Easy

Objective: LO 7-4

AACSB: Reflective thinking skills

39) Whenever practical and reasonable, the confirmation of accounts receivable is required of CPAs.

A) True

B) False

Answer: A

Terms: Confirmations of accounts receivable required of CPAs

Diff: Easy

Objective: LO 7-4

AACSB: Reflective thinking skills

40) Inquiries of clients and reperformance normally have a low cost associated with them.

A) True

B) False

Answer: A

Terms: Inquiries of clients and reperformance have low cost

Diff: Easy

Objective: LO 7-4

AACSB: Reflective thinking skills

41) When analytical procedures reveal unusual fluctuations in an account balance, the auditor will probably perform fewer tests of details for that account and increase the tests of controls related to the account.

A) True

B) False

Answer: B

Terms: Analytical procedures reveal unusual fluctuations

Diff: Easy

Objective: LO 7-4

AACSB: Reflective thinking skills

42) The type of audit evidence known as inquiry requires the auditor to obtain oral information from the client in response to questions.

A) True

B) False

Answer: A

Terms: Audit evidence; Inquiry

Diff: Easy

Objective: LO 7-4

AACSB: Reflective thinking skills

43) Auditor judgment is the primary determinant in determining the amount of evidence gathered.

A) True

B) False

Answer: A

Terms: Auditor judgment; Evidence

Diff: Moderate

Objective: LO 7-4

AACSB: Reflective thinking skills

44) Analytical procedures must be used in the planning and completion phases of the audit.

A) True

B) False

Answer: A

Terms: Analytical procedures used in planning and completion phases of audit

Diff: Moderate

Objective: LO 7-4

AACSB: Reflective thinking skills

45) Confirmations are ordinarily used to verify account balances, but may be used to verify transactions.

A) True

B) False

Answer: A

Terms: Confirmations to verify balances and transactions

Diff: Moderate

Objective: LO 7-4

AACSB: Reflective thinking skills

46) Accounts receivable confirmations must be controlled by the client from the time they are prepared until the time they are returned to the auditor.

A) True

B) False

Answer: B

Terms: Confirmations control

Diff: Moderate

Objective: LO 7-4

AACSB: Reflective thinking skills

47) Cost is never an adequate justification for omitting a necessary procedure or not gathering an adequate sample size.

A) True

B) False

Answer: A

Terms: Cost of audit procedures; Sample size

Diff: Moderate

Objective: LO 7-4

AACSB: Reflective thinking skills

48) Analytical procedures can be used to provide reliable substantive evidence for all balance-related audit objectives.

A) True

B) False

Answer: B

Terms: Analytical procedures

Diff: Moderate

Objective: LO 7-4

AACSB: Reflective thinking skills

49) One advantage of using statistical techniques when performing analytical procedures is that they eliminate the need for auditor judgment.

A) True

B) False

Answer: B

Terms: Analytical procedures

Diff: Moderate

Objective: LO 7-4

AACSB: Reflective thinking skills

Learning Objective 7-5

1) Which of the following best describes one of the primary objectives of audit documentation?

- A) Defend against claims of a deficient audit.
- B) Provide a basis for reviewing the work of subordinates.
- C) Provide reasonable assurance that the audit was conducted in accordance with auditing standards.
- D) Provide additional support of recorded amounts to the client.

Answer: C

Terms: Primary objective of audit documentation

Diff: Moderate

Objective: LO 7-5

AACSB: Reflective thinking skills

2) The permanent files included as part of audit documentation do not normally include:

- A) a copy of the current and prior years' audit programs.
- B) copies of articles of incorporation, bylaws and contracts.
- C) information related to the understanding of internal control.
- D) results of analytical procedures from prior years.

Answer: A

Terms: Permanent files as audit documentation

Diff: Moderate

Objective: LO 7-5

AACSB: Reflective thinking skills

3) The auditor's results of evidence gathering procedures are contained in audit documentation for the audit. When preparing the requisite audit, documentation should be cognizant of:

- A) Documents are kept by the client for easy reference for their accounting staff.
- B) Audit documents should be considered as a substitute for the clients accounting records.
- C) Audit documents are designed to facilitate the review and supervision of the work performed by the audit team by a reviewing partner.
- D) Audit documents are the sole source of evidence that an auditor uses in forming an opinion about the client's financial statements.

Answer: C

Terms: Audit documentation for audit

Diff: Moderate

Objective: LO 7-5

AACSB: Reflective thinking skills

4) Audit documentation should provide support for:

A)

| | |
|------------------|--------------------------|
| The audit report | The financial statements |
| Yes | Yes |

B)

| | |
|------------------|--------------------------|
| The audit report | The financial statements |
| No | No |

C)

| | |
|------------------|--------------------------|
| The audit report | The financial statements |
| Yes | No |

D)

| | |
|------------------|--------------------------|
| The audit report | The financial statements |
| No | Yes |

Answer: C

Terms: Audit documentation should provide support

Diff: Challenging

Objective: LO 7-5

AACSB: Reflective thinking skills

5) Audit documentation is the joint property of the auditor and the audit client.

A) True

B) False

Answer: B

Terms: Audit documentation

Diff: Moderate

Objective: LO 7-5

AACSB: Reflective thinking skills

6) Ordinarily, audit documentation can be provided to someone else only with the express permission of the client.

A) True

B) False

Answer: A

Terms: Audit documentation provided with permission of client

Diff: Moderate

Objective: LO 7-5

AACSB: Reflective thinking skills

Learning Objective 7-6

1) What client information is needed by auditors in creating lead schedules?

- A) Interim statements prepared by the client for the company's 3rd quarter financial results.
- B) General ledger information, including unadjusted ending balances and beginning balances for accounts.
- C) A schedule of adjusting entries made by the client for all balance sheet accounts.
- D) Detailed transaction information that may explain the changes in balance sheet accounts for the current year under audit.

Answer: B

Terms: Client information needed for an auditor to create lead schedules

Diff: Challenging

Objective: LO 7-6

AACSB: Reflective thinking skills

2) Audit documentation should possess certain characteristics. Which of the following is true regarding those characteristics?

A)

| | |
|--|---|
| Audit documentation should be indexed and cross-referenced | Audit documentation should be organized to benefit the client's staff |
| Yes | Yes |

B)

| | |
|--|---|
| Audit documentation should be indexed and cross-referenced | Audit documentation should be organized to benefit the client's staff |
| No | No |

C)

| | |
|--|---|
| Audit documentation should be indexed and cross-referenced | Audit documentation should be organized to benefit the client's staff |
| Yes | No |

D)

| | |
|--|---|
| Audit documentation should be indexed and cross-referenced | Audit documentation should be organized to benefit the client's staff |
| No | Yes |

Answer: C

Terms: Audit documentation characteristics

Diff: Challenging

Objective: LO 7-6

AACSB: Reflective thinking skills

3) The permanent audit file would usually include the following:

- A) client's working trial balance
- B) summary of the risk assessment procedures performed
- C) organizational chart of the company's employees
- D) summary of the auditors test of controls for the current years audit

Answer: C

Terms: Permanent file

Diff: Challenging

Objective: LO 7-6

AACSB: Reflective thinking skills

4) When determining sufficient and appropriate audit evidence in order to form an opinion on the client's financial statements the auditor compiles audit documentation to support the opinion. The largest portion of audit documentation will include detailed supporting schedules prepared by the client or the auditor in support of specific accounts on the financial statements. The major types of supporting schedules include analysis schedules and tests of reasonableness. Discuss those two schedules and give an example for each schedule.

Answer: Analysis: designed to show the activity in a general ledger account during the entire period under audit, tying together the beginning and ending balances. For example, marketable securities, property, plant and equipment, long-term debt, equity accounts. Auditors are focusing on the significance of the activity in the account during the year.

Tests of Reasonableness: Contains information that enables the auditor to evaluate whether the client's balance appears to contain a misstatement. Example, depreciation expense, allowance for uncollectibles, income tax provision. Tests are primarily analytical procedure tests in which the auditor forms an expectation of the balance that appears in the working trial balance.

Terms: Major types of supporting schedules; Analysis and tests of reasonableness

Diff: Moderate

Objective: LO 7-6

AACSB: Reflective thinking skills

5) The basis for preparing financial statements for companies is the general ledger. As soon as possible the auditor obtains the general ledger accounts of the client and prepares a working trial balance. Discuss the audit documentation in the current file that relates to the working trial balance. Include a description of lead and support schedules in your answer.

Answer: Lead Schedules—each line item on the working trial balance is supported by a lead schedule, containing the detailed accounts from the general ledger making up the line item in the working trial balance.

Support Schedules—each detailed account of the lead schedule is supported by proper schedules supporting the audit work performed and the conclusions reached by the auditors.

Terms: Audit documentation in current file; Working trial balance; Lead schedules and support schedules

Diff: Moderate

Objective: LO 7-6

AACSB: Reflective thinking skills