

Auditing and Assurance Services, 15e, Global Edition (Arens)
Chapter 6 Audit Responsibilities and Objectives

Learning Objective 6-1

1) The objective of an audit of the financial statements is an 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) determine if the financial statements are correct.

C) satisfy the requirements of the Securities Acts of 1933 and 1934.

D) reach a conclusion 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 management insists on financial statement disclosures that the auditor finds unacceptable, the auditor can withdraw from the engagement or:

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 requires neither 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) Because they operate the business on a daily basis, a company's management knows more about the company's transactions and related assets, liabilities, and equity than the auditors.

A) True

B) False

Answer: A

Terms: Responsibility for fair presentation of financial statements

Diff: Easy

Objective: LO 6-2

AACSB: Reflective thinking skills

7) The annual reports of many public companies include a statement about management's responsibilities and relationship with the CPA firm.

A) True

B) False

Answer: A

Terms: Management's responsibility and relationship with CPA firm

Diff: Easy

Objective: LO 6-2

AACSB: Reflective thinking skills

8) The auditors determine which disclosures must be presented in the financial statements.

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) An audit must be performed with an attitude of professional skepticism. Professional skepticism consists of two primary components: a questioning mind and:

A) the assumption that upper-level management is dishonest.

B) a critical assessment of the audit evidence.

C) the assumption that all employees are motivated by greed.

D) verification of all critical information by independent third parties.

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 the 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) obtain an understanding of the nature and circumstances of the act.
- B) consult with legal counsel or others knowledgeable about the illegal act.
- C) discuss the matter with the audit committee.
- 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) An auditor discovers that the company's bookkeeper unintentionally made an mistake in calculating the amount of the quarterly sales. This is an example of:

- A) employee fraud.
- B) an error.**
- C) misappropriation of assets.
- D) a defalcation.

Answer: B

Terms: Errors and fraud

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) One of the characteristics of professional skepticism is _____, which is the conviction to decide for oneself, rather than accepting the claims of others.

A) interpersonal understanding

B) autonomy

C) suspension of judgment

D) self-esteem

Answer: B

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

Diff: Moderate

Objective: LO 6-3

AACSB: Reflective thinking skills

16) When dealing with laws and regulations that do not have a direct effect on the financial statements, the auditor:

A) should inquire of management about whether the entity is in compliance with such laws and regulations.

B) has no responsibility to determine if any violations of these laws has occurred.

C) must report all violations, including inconsequential violations, to the audit committee.

D) should perform the same procedures as for violations having a direct 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) Materiality is easy to quantify.

B) Fraudulent financial statements are often easy for the auditor to detect, especially when there is collusion among management.

C) Reasonable assurance is a low level of assurance that the financial statements are free from material misstatement.

D) An item is considered material if it would likely have changed or influenced the decisions of a reasonable person using the statements.

Answer: D

Terms: Materiality

Diff: Moderate

Objective: LO 6-3

AACSB: Reflective thinking skills

18) Auditing standards make _____ 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: Challenging

Objective: LO 6-3

AACSB: Reflective thinking skills

20) Misappropriation of assets:

- A) is generally committed by company management.
- B) harms the users of the financial statements by providing them incorrect financial data for their decision making.
- C) causes harm to stockholders because the assets are no longer available to their rightful owners.
- D) causes the financial statements to be misstated since the misappropriation usually involves material amounts.

Answer: C

Terms: Misappropriation of assets fraud

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 errors and employee fraud.

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 identifies or suspects noncompliance with laws and regulations, the auditor:

- A) should discuss the matter with those whom they believe committed the illegal act.
- B) begin communication with the FASB in accordance with PCAOB regulations.
- C) may disclaim an opinion on the basis of scope limitations if he is precluded by management from obtaining sufficient appropriate evidence.
- D) should withdraw from the engagement.

Answer: C

Terms: Illegal acts occurred

Diff: Moderate

Objective: LO 6-3

AACSB: Reflective thinking skills

25) When an auditor knows that an illegal act has occurred, she 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

Topic: Public

26) A questioning mindset:

- A) means the auditor must prove every statement that management makes to them.
- B) means the auditor should approach the audit with a "do not trust anyone" mental outlook.
- C) assures that the auditor will only accept honest clients.
- D) means the auditor should approach the audit with a "trust but verify" mental outlook.

Answer: B

Terms: Professional skepticism

Diff: Moderate

Objective: LO 6-3

AACSB: Reflective thinking skills

27) Which of the following is an accurate statement concerning the auditor's responsibility to consider laws and regulations?

A) Auditors can follow an easy, step-by-step procedure to determine how laws and regulations impact the financial statements.

B) The auditor's responsibility will depend on whether the laws or regulations are expected to have a direct impact on the financial statements.

C) It is the responsibility of the auditor to determine if an act constitutes noncompliance.

D) The auditor must inform an outside party if management has knowingly not complied with a law or regulation.

Answer: B

Terms: Illegal acts effect on financial statements

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 is responsible for detecting material financial statement fraud, but not a material misappropriation of assets.

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.

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) One of the characteristics of professional skepticism is _____, which is a desire to investigate beyond the obvious.

A) self-esteem

B) an interpersonal understanding

C) a search for knowledge

D) a questioning mindset

Answer: C

Terms: Professional skepticism

Diff: Moderate

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) If a client has violated federal tax laws:

A) the auditor must notify the IRS.

B) and the amount is significant, the auditor should communicate with those charged with governance.

C) the noncompliance generally will not impact the financial statements.

D) the auditor does not need to evaluate the effects of the noncompliance on other aspects of the audit.

Answer: B

Terms: Illegal acts effect on financial statements

Diff: Moderate

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 the majority of the 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 an illegal act is identified or suspected.

Answer: When an auditor discovers or suspects noncompliance with a law or regulation (illegal act), unless the matters involved are inconsequential, the auditor should:

1. 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 auditor should express a qualified or adverse opinion on the financial statements. If the auditor is precluded by management or those charged with governance from obtaining sufficient appropriate evidence to evaluate whether noncompliance that may be material to the financial statements has occurred or is likely to have occurred, the auditor should express a qualified opinion or disclaim an opinion on the financial statements on the basis of the scope limitation.
2. Communicate with those charged with governance matters involving noncompliance with laws and regulations that came to the auditor's attention during the course of the audit. If the matter is believed to be intentional and material, it should be communicated to those charged with governance, such as the board of directors, as soon as practicable.
3. Identify whether a responsibility exists to report the identified or suspected noncompliance to parties outside the entity, such as regulatory authorities.
4. Evaluate the effects of the noncompliance on other aspects of the audit, including the auditor's risk assessment and the reliability of other representations from management.

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) illegal acts having a direct effect on the financial statements, and (4) illegal acts that do not have a direct effect on the financial statements.

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 illegal acts that have a direct effect on the financial statements is the same as for errors and fraud. However, the auditor is not required to search for illegal acts that do not have a direct effect on the financial statements 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) The concept of professional skepticism has been a foundational element of auditing standards for year and continues to be difficult to implement in practice. Recent academic research on the topic of professional skepticism suggests that there are six characteristics to skepticism. List and briefly describe each of these characteristics.

Answer: The six characteristics of skepticism are:

1. Questioning mindset - a disposition to inquiry with some sense of doubt
2. Suspension of judgment - withholding judgment until appropriate evidence is obtained
3. Search for knowledge - a desire to investigate beyond the obvious, with a desire to corroborate
4. Interpersonal understanding - recognition that people's motivations and perceptions can lead them to provide biased or misleading information
5. Autonomy - the self-direction, moral independence, and conviction to decide for oneself, rather than accepting the claims of others
6. Self-esteem - the self-confidence to resist persuasion and to challenge assumptions or conclusions.

Terms: Professional skepticism

Diff: Moderate

Objective: LO 6-3

AACSB: Reflective thinking skills

41) 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

42) 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 illegal acts that do not have a direct effect on the financial statements unless there is reason to believe they may exist.

A) True

B) False

Answer: A

Terms: Auditor responsibility for searching for illegal acts that do not have a direct effect on the financial statements

Diff: Easy

Objective: LO 6-3

AACSB: Reflective thinking skills

43) 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 and if there is a direct impact on the financial statements.

A) True

B) False

Answer: A

Terms: Auditor believes illegal act may have occurred

Diff: Easy

Objective: LO 6-3

AACSB: Reflective thinking skills

44) 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

45) Auditors have a higher degree of responsibility for detecting illegal acts that have a direct effect on the financial statements than illegal acts that do not have a direct effect on the financial statements.

A) True

B) False

Answer: A

Terms: Auditor degree of responsibility for detecting illegal acts

Diff: Moderate

Objective: LO 6-3

AACSB: Reflective thinking skills

46) 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, law enforcement and 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

47) An audit generally provides no assurance that illegal acts that do not have a direct effect on the financial statements 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

48) 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) False

Answer: B

Terms: Moderate or high risk of management fraud

Diff: Moderate

Objective: LO 6-3

AACSB: Reflective thinking skills

49) Asking the right questions and probing further until the auditor is satisfied with the responses can help the auditor to detect a material misstatement in the financial statements.

A) True

B) False

Answer: A

Terms: Professional skepticism

Diff: Moderate

Objective: LO 6-3

AACSB: Reflective thinking skills

50) 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

51) As the impact from noncompliance is further removed from affecting the financial statements, the less likely the auditor is to become aware of or recognize noncompliance when auditing the financial statements.

A) True

B) False

Answer: A

Terms: Auditor responsibility for searching for illegal acts that do not have a direct effect on the financial statements

Diff: Moderate

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 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) The cycle approach to auditing:

- A) ties to the way transactions are recorded in journals and then summarized in the general ledger and financial statements.
- B) cannot combine transactions recorded in different journals with the general ledger balances that result from those transactions.
- C) is the only way of segmenting an audit.
- D) assumes that each account has two or more cycles associated with it.

Answer: A

Terms: Cycle approach to segmenting an audit

Diff: Moderate

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) Listed below are several accounts listed from a company's trial balance. Next to each account put the letter corresponding to the transaction cycle used to audit the account:

S = Sales and collection cycle I = Inventory and warehousing cycle
A = Acquisition and payment cycle C = Capital acquisition and repayment cycle
P = Payroll and personnel cycle

- | | | | |
|----------|------------------------------|----------|---------------------------|
| 1. _____ | Sales returns and allowances | 5. _____ | Salaries and commissions |
| 2. _____ | Capital stock | 6. _____ | Cost of goods sold |
| 3. _____ | Buildings | 7. _____ | Trade accounts receivable |
| 4. _____ | Notes payable | 8. _____ | Rent |

Answer: 1. S, 2. C, 3. A, 4. C, 5. P, 6. I, 7. S, 8. A

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

Diff: Moderate

Objective: LO 6-4

AACSB: Reflective thinking skills

9) 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

10) Under the cycle approach, the only accounts that have two or more cycles associated with them are cash and accounts receivable.

A) True

B) False

Answer: B

Terms: Cycle approach to segmenting an audit

Diff: Moderate

Objective: LO 6-4

AACSB: Reflective thinking skills

11) Although auditors need to consider the interrelationships between cycles, they typically treat cycles independently to the extent practical to manage complex audits effectively.

A) True

B) False

Answer: A

Terms: Cycle approach to segmenting an audit

Diff: Moderate

Objective: LO 6-4

AACSB: Reflective thinking skills

12) When examining the relationships of the five cycles and general cash, the cycles have no beginning or end except at the origin or final disposition of the company.

A) True

B) False

Answer: A

Terms: Cycle approach to segmenting an audit

Diff: Moderate

Objective: LO 6-4

AACSB: Reflective thinking skills

Learning Objective 6-5

1) Auditors have found that generally the most efficient and effective way to conduct audits is to:

A) obtain complete assurance about the correctness of each class of transactions affecting the account.

B) obtain some combination of assurance for each class of transactions and for the ending balance in the related accounts.

C) obtain assurance about the ending balance of the account only.

D) verify each entry that was made into an account.

Answer: B

Terms: Setting audit objectives

Diff: Moderate

Objective: LO 6-5

AACSB: Reflective thinking skills

2) The term audit objective refers to all of the following **except** for:

A) transaction-related audit objectives.

B) presentation and disclosure-related audit objectives.

C) balance-related audit objectives.

D) cycle-related audit objectives.

Answer: D

Terms: Setting audit objectives

Diff: Easy

Objective: LO 6-5

AACSB: Reflective thinking skills

3) When an auditor is determining what information to include in the notes to the financial statements relating to bonds payable, he is concerned with the transaction-related audit objectives.

A) True

B) False

Answer: B

Terms: Setting audit objectives

Diff: Moderate

Objective: LO 6-4

AACSB: Reflective thinking skills

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 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) Management makes the following assertions about account balances:

- A) existence, completeness, classification and cutoff.
- B) existence, accuracy, classification and rights and obligations.
- C) existence, completeness, valuation and allocation, and rights and obligations.
- D) existence, completeness, rights and obligations, and cutoff.

Answer: C

Terms: Management assertions

Diff: Challenging

Objective: LO 6-6

AACSB: Reflective thinking skills

6) Which of the following statements is true about the completeness and occurrence assertions?

- A) Both assertions are relevant to classes of transactions and events and account balances.
- B) If management asserts that recorded sales transactions represent exchanges of goods or services that actually took place, they are asserting to completeness.
- C) Violations of the occurrence assertion relate to account overstatements.
- D) The failure to record a sale that did occur is a violation of the occurrence assertion.

Answer: C

Terms: Completeness transaction-related audit objective

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 classes of transactions and events?

- A) Occurrence
- B) Classification
- C) Accuracy
- D) Rights and obligations

Answer: D

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

12) Relevant assertions have a meaningful bearing on whether the account is fairly stated and are used to assess the risk of material misstatement and the design and performance of audit procedures.

A) True

B) False

Answer: A

Terms: Management assertions

Diff: Moderate

Objective: LO 6-6

AACSB: Reflective thinking skills

13) The auditor's audit objectives follow and are closely related to management assertions.

A) True

B) False

Answer: A

Terms: Management assertions

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 class of transactions?

A) The specific audit objectives are applicable to every class of transactions.

B) The general audit objectives are applicable to every class of transactions.

C) Once the specific transaction-related audit objectives are established, they can be used to develop the general transaction-related objectives.

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 the correct selling price was used for billing and that the quantity of goods shipped was the same as the quantity billed. 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) The posting and summarization audit objective is the auditor's counterpart to management's assertion of:

A) occurrence.

B) completeness.

C) accuracy.

D) classification.

Answer: C

Terms: Transaction-related audit objectives

Diff: Moderate

Objective: LO 6-7

AACSB: Reflective thinking skills

4) After the general transaction related-audit objectives are understood, specific transaction-related audit objectives for each material class of transactions 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 occurrence 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 occurrence 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 occurrence objective result in overstatements of sales; violations of the completeness objective result in understatements of sales.

Terms: General and specific 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) If a sale was for a valid shipment, but the amount of the sales invoice was calculated incorrectly, the accuracy objective was violated.

A) True

B) False

Answer: A

Terms: General transaction-related audit objectives

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 classification balance-related audit objective:

- A) involves determining if items included on a client's listing are included in the correct general ledger accounts.
- B) is the counterpart to the management assertion of completeness.
- C) involves determining if items included on a client's listing are disclosed properly in the financial statements.
- D) involves tying in the account balances to the general ledger.

Answer: A

Terms: Balance-related audit objectives

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 audit objective is realizable value. Describe the purpose of this audit objective, what it is concerned with, and give an example.

Answer: Purpose—to make sure that 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) F (2) X
- (1) E (2) X
- (1) G (2) X
- (1) H (2) Y
- (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) Determining that the footnote disclosures related to long-term debt are accurate is an example of the _____ audit objective.

A) occurrence

B) completeness

C) presentation and disclosure

D) classification and understandability

Answer: C

Terms: Presentation and disclosure-related objectives

Diff: Easy

Objective: LO 6-9

AACSB: Reflective thinking skills

2) The presentation and disclosure-related audit objectives are identical to the management assertions for presentation and disclosure.

A) True

B) False

Answer: A

Terms: Presentation and disclosure-related objectives

Diff: Easy

Objective: LO 6-9

AACSB: Reflective thinking skills

Learning Objective 6-10

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

A) test for monetary misstatements 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 based on risk assessment procedures

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 an audit 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 consist of evaluations of financial information through analysis of plausible relationships among financial and nonfinancial data. Analytical procedures use comparisons and relationships to assess whether account balances and other data appear reasonable. An example of an analytical procedure is to 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 in the financial statements. An example is 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

11) Rights and obligations is the only balance-related assertion without a similar transaction related assertion.

A) True

B) False

Answer: A

Terms: Audit process

Diff: Moderate

Objective: LO 6-10

AACSB: Reflective thinking skills

12) The audit objectives are the well-defined methodology for organizing an audit to ensure that the evidence gathered is sufficient and appropriate.

A) True

B) False

Answer: B

Terms: Audit process

Diff: Moderate

Objective: LO 6-10

AACSB: Reflective thinking skills

13) Obtaining an understanding of the entity and its environment is part of the analytical procedures phase of the audit.

A) True

B) False

Answer: B

Terms: Audit process

Diff: Moderate

Objective: LO 6-10

AACSB: Reflective thinking skills

14) An auditor assesses the risk of material misstatement to determine the impact on the audit plan and to determine the nature, extent, and timing of the audit procedures.

A) True

B) False

Answer: A

Terms: Audit process

Diff: Moderate

Objective: LO 6-10

AACSB: Reflective thinking skills