

Auditing and Assurance Services, 15e, Global Edition (Arens)
Chapter 9 Considering Materiality and Audit Risk

Learning Objective 9-1

1) If it is probable that the judgment of a reasonable person will be changed or influenced by the omission or misstatement of information, then that information is, by definition of FASB Statement No. 2:

- A) material.
- B) insignificant.
- C) significant.
- D) relevant.

Answer: A

Terms: FASB Statement No. 2; Probable judgment of a reasonable person

Diff: Easy

Objective: LO 9-1

AACSB: Reflective thinking skills

2) The scope paragraph of the standard unqualified auditor's report states that "... the standards require that we plan and perform the audit to obtain _____ assurance about whether the financial statements are free of material misstatement." What type of assurance is given?

- A) Immediate
- B) Limited
- C) Reasonable
- D) Absolute

Answer: C

Terms: Type of assurance provided

Diff: Easy

Objective: LO 9-1

AACSB: Reflective thinking skills

3) Auditors are responsible for determining whether financial statements are materially misstated, so upon discovering a material misstatement they must bring it to the attention of:

- A) regulators.
- B) the audit firm's managing partner.
- C) the client shareholders.
- D) the client.

Answer: D

Terms: Discovery of a material misstatement must bring it to the attention

Diff: Easy

Objective: LO 9-1

AACSB: Reflective thinking skills

4) Determining materiality requires professional judgment.

A) True

B) False

Answer: A

Terms: Materiality

Diff: Easy

Objective: LO 9-1

AACSB: Reflective thinking skills

Learning Objective 9-2

1) Audit standards require the auditor to consider materiality early in the audit. Which statement(s) regarding preliminary materiality are true?

I. Preliminary materiality may change during the engagement.

II. Preliminary materiality is the maximum amount by which the auditor believes the financials could be misstated and still not affect the decisions of reasonable users.

A) I only

B) II only

C) both I and II

D) neither are true

Answer: C

Terms: Preliminary materiality assessment

Diff: Easy

Objective: LO 9-2

AACSB: Reflective thinking skills

2) Why do auditors establish a preliminary judgment about materiality?

A) To determine the appropriate level of staff to assign to the audit

B) So that the client can know what records to make available to the auditor

C) To help plan the appropriate evidence to accumulate

D) To finalize the control risk assessment

Answer: C

Terms: Purpose to establish preliminary judgment about materiality

Diff: Easy

Objective: LO 9-2

AACSB: Reflective thinking skills

3) If an auditor establishes a relatively high level for materiality, then the auditor will:

A) accumulate more evidence than if a lower level had been set.

B) accumulate less evidence than if a lower level had been set.

C) accumulate approximately the same evidence as would be the case were materiality lower.

D) accumulate an undetermined amount of evidence.

Answer: B

Terms: High level for materiality

Diff: Easy

Objective: LO 9-2

AACSB: Reflective thinking skills

4) The preliminary judgment about materiality and the amount of audit evidence accumulated are _____ related.

- A) directly
- B) indirectly
- C) not
- D) inversely

Answer: D

Terms: Preliminary judgment about materiality and amount of evidence accumulated

Diff: Easy

Objective: LO 9-2

AACSB: Reflective thinking skills

5) Which of the following is the primary basis used to decide materiality for a for-profit entity?

- A) Net sales
- B) Net assets
- C) Net income before tax
- D) All of the above

Answer: C

Terms: Primary basis to decide materiality for a for-profit entity

Diff: Easy

Objective: LO 9-2

AACSB: Reflective thinking skills

6) Auditing standards _____ that the basis used to determine the preliminary judgment about materiality be documented in the audit files.

- A) permit
- B) do not allow
- C) require
- D) strongly encourage

Answer: C

Terms: Auditing standards; Preliminary judgment about materiality documented

Diff: Easy

Objective: LO 9-2

AACSB: Reflective thinking skills

7) Amounts involving fraud are usually considered _____ important than unintentional errors of equal dollar amounts.

- A) less
- B) no less
- C) no more
- D) more

Answer: D

Terms: Amounts involving fraud

Diff: Easy

Objective: LO 9-2

AACSB: Reflective thinking skills

8) Qualitative factors can affect an auditor's assessment of materiality. Which of the following statements is true?

- I. Misstatements that are otherwise immaterial may be material if they affect earnings trends.
- II. Misstatements that are otherwise minor may be material if there are possible consequences arising from contractual obligations.

- A) I only
- B) II only
- C) I and II
- D) neither I nor II

Answer: C

Terms: Qualitative factors can affect auditor's assessment of materiality

Diff: Easy

Objective: LO 9-2

AACSB: Reflective thinking skills

9) The five steps in applying materiality are listed below in random order.

- 1. Estimate the combined misstatement.
- 2. Estimate the total misstatement in the segment.
- 3. Set materiality for the financial statements as a whole.
- 4. Determine performance materiality.
- 5. Compare combined estimate with preliminary judgment about materiality.

The first three steps in correct sequence would be:

- A) 1, 2, 5
- B) 3, 4, 2
- C) 2, 1, 5
- D) 3, 2, 4

Answer: B

Terms: Five steps in applying materiality

Diff: Moderate

Objective: LO 9-2

AACSB: Reflective thinking skills

10) Which of the following statements is **not** correct?

- A) Materiality is a relative rather than an absolute concept.
- B) The most important base used as the criterion for deciding materiality is total assets.
- C) Qualitative factors as well as quantitative factors affect materiality.
- D) Given equal dollar amounts, frauds are usually considered more important than errors.

Answer: B

Terms: Materiality

Diff: Moderate

Objective: LO 9-2

AACSB: Reflective thinking skills

11) Certain types of misstatements are likely to be more important than other types to users, even if the dollar amounts are the same. Which of the following demonstrates this?

A)

Amounts involving frauds are considered more important than errors of equal amount	Misstatements that are otherwise immaterial may be material if they affect a trend in earnings
Yes	Yes

B)

Amounts involving frauds are considered more important than errors of equal amount	Misstatements that are otherwise immaterial may be material if they affect a trend in earnings
No	No

C)

Amounts involving frauds are considered more important than errors of equal amount	Misstatements that are otherwise immaterial may be material if they affect a trend in earnings
Yes	No

D)

Amounts involving frauds are considered more important than errors of equal amount	Misstatements that are otherwise immaterial may be material if they affect a trend in earnings
No	Yes

Answer: A

Terms: Certain types of misstatements are likely more important than other types

Diff: Moderate

Objective: LO 9-2

AACSB: Reflective thinking skills

12) When setting a preliminary judgment about materiality:

A) more evidence is required for a low dollar amount than for a high dollar amount.

B) less evidence is required for a low dollar amount than for a high dollar amount.

C) the same amount of evidence is required for either low or high dollar amounts.

D) there is no relationship between it and the dollar amount of evidence needed.

Answer: A

Terms: Setting preliminary judgment about materiality

Diff: Challenging

Objective: LO 9-2

AACSB: Reflective thinking skills

13) Lewis Corporation has a few large accounts receivable that total one million dollars whereas Clark Corporation has many small accounts receivable that total one million dollars.

Misstatement in any one account is more significant for Lewis corporation because of the concept of:

- A) materiality.
- B) audit risk.
- C) reasonable assurance.
- D) comparative analysis.

Answer: A

Terms: Misstatements

Diff: Challenging

Objective: LO 9-2

AACSB: Reflective thinking skills

14) Audit standards require the auditor to consider the combined amount of misstatement early in the audit. This is known as preliminary materiality judgment. List and discuss the three main factors that affect an auditor's preliminary judgment about materiality.

Answer: The three main factors that affect an auditor's judgment about materiality are:

- *Materiality is a relative rather than an absolute concept.* A misstatement of a given size might be material for a small company, whereas the same dollar misstatement could be immaterial for a larger one.
- *Benchmarks are needed for evaluating materiality.* Because materiality is relative, it is necessary to have benchmarks for establishing whether misstatements are material. Net income before taxes is normally the most commonly used benchmark, but other possible benchmarks include current assets, total assets, current liabilities, and owners' equity.
- *Qualitative factors also affect materiality.* Certain types of misstatements are likely to be more important to users than others, even if the dollar amounts are the same, such as misstatements involving frauds.

Terms: Factors that affect auditor's preliminary judgment

Diff: Moderate

Objective: LO 9-2

AACSB: Reflective thinking skills

15) Due to qualitative factors, certain types of misstatements are likely to be more important to users than others, even if the dollar amounts are the same. Identify two qualitative factors that might significantly affect an auditor's materiality judgment, and give an example of each.

Answer: Qualitative factors that affect an auditor's materiality judgment include:

- *Amounts involving fraud.* Amounts involving fraud are usually considered more important than unintentional errors of equal dollar amounts because fraud reflects on the honesty and reliability of the management or other personnel involved. For example, an intentional misstatement of inventory would be more important to users than a clerical error in inventory of the same amount.
- *Misstatements affecting contractual obligations.* Misstatements that are otherwise minor may be material if there are possible consequences arising from contractual obligations. For example, if a misstatement causes a required minimum account balance to exceed the minimum, when the correct balance is less than the minimum, this misstatement likely would be important to users.
- *Amounts affecting a trend in earnings.* Amounts that are otherwise immaterial may be material if they affect a trend in earnings. An example is if reported income has increased 3 percent annually for the past five years but income for the current year has declined 1 percent, that change may be material. Similarly, a misstatement that would cause a loss to be reported as a profit may be of concern.

Terms: Qualitative factors that affect auditor's materiality judgment

Diff: Moderate

Objective: LO 9-2

AACSB: Reflective thinking skills

16) The auditor's preliminary judgment about materiality is the maximum amount by which the auditor believes the financial statements could be misstated and still not affect the decisions of reasonable users.

A) True

B) False

Answer: A

Terms: Preliminary judgments about materiality

Diff: Easy

Objective: LO 9-2

AACSB: Reflective thinking skills

17) Preliminary judgments about materiality are often changed during the course of the engagement.

A) True

B) False

Answer: A

Terms: Preliminary judgments about materiality

Diff: Easy

Objective: LO 9-2

AACSB: Reflective thinking skills

18) Net assets are the most often used base for deciding materiality.

A) True

B) False

Answer: B

Terms: Base for deciding materiality

Diff: Easy

Objective: LO 9-2

AACSB: Reflective thinking skills

19) The lower the dollar amount of the preliminary judgment the more audit evidence is required.

A) True

B) False

Answer: A

Terms: Amount of preliminary judgment and audit evidence required

Diff: Easy

Objective: LO 9-2

AACSB: Reflective thinking skills

20) Amounts involving fraud are not usually considered qualitative factors affecting the preliminary materiality judgment.

A) True

B) False

Answer: B

Terms: Qualitative factors affecting preliminary materiality judgment; Fraud

Diff: Easy

Objective: LO 9-2

AACSB: Reflective thinking skills

21) CPA firms can establish policy guidelines to help their auditors determine materiality.

A) True

B) False

Answer: A

Terms: Difficulty in applying concept of materiality

Diff: Moderate

Objective: LO 9-2

AACSB: Reflective thinking skills

22) Statements on Auditing Standards provide detailed, objective guidance on how auditors are to establish a preliminary materiality level, thus eliminating the need for subjective auditor judgment in this task.

A) True

B) False

Answer: B

Terms: Statements on Auditing Standards; Objective guidance on establishing preliminary materiality level

Diff: Moderate

Objective: LO 9-2

AACSB: Reflective thinking skills

23) If the preliminary judgment of materiality increases, the amount of audit evidence required will decrease.

A) True

B) False

Answer: A

Terms: Preliminary judgment of materiality and audit evidence

Diff: Moderate

Objective: LO 9-2

AACSB: Reflective thinking skills

24) Net income before tax is the normal base used to determine materiality in a not-for-profit company.

A) True

B) False

Answer: B

Terms: Base used to determine materiality

Diff: Moderate

Objective: LO 9-2

AACSB: Reflective thinking skills

Learning Objective 9-3

1) When auditors allocate the preliminary judgment about materiality to account balances, the materiality allocated to any given account balance is referred to as:

A) the materiality range.

B) the error range.

C) tolerable materiality.

D) performance materiality.

Answer: D

Terms: Allocate preliminary judgment about materiality to account balances

Diff: Easy

Objective: LO 9-3

AACSB: Reflective thinking skills

2) Auditors generally allocate the preliminary judgment about materiality to the:

- A) balance sheet only.
- B) income statement only.
- C) income statement and balance sheet.
- D) statement of cash flows.

Answer: A

Terms: Preliminary materiality allocation

Diff: Easy

Objective: LO 9-3

AACSB: Reflective thinking skills

3) Which of the following is an incorrect statement regarding the allocation of the preliminary judgment about materiality to balance sheet accounts?

- A) Auditors expect certain accounts to have more misstatements than others.
- B) The allocation has virtually no effect on audit costs because the auditor must collect sufficient appropriate audit evidence.
- C) Auditors expect to identify overstatements as well as understatements in the accounts.
- D) Relative audit costs affect the allocation.

Answer: B

Terms: Allocation of preliminary judgment about materiality

Diff: Moderate

Objective: LO 9-3

AACSB: Reflective thinking skills

4) Which of the following statements is true concerning the allocation of preliminary materiality?

- A) It is necessary to allocate preliminary materiality to financial statements as a whole rather than by segments.
- B) Preliminary materiality should be allocated to income statement accounts only.
- C) Preliminary materiality is required by the SEC.
- D) The PCAOB term used when preliminary materiality is allocated to segments is tolerable misstatement.

Answer: D

Terms: Allocation of preliminary materiality

Diff: Moderate

Objective: LO 9-3

AACSB: Reflective thinking skills

5) Which of the following statements is false?

- A) Either an overstatement of an asset account or an understatement of a liability account would have the same effect on the income statement.
- B) A misclassification in the balance sheet will have no effect on operating income.
- C) Either an overstatement of an asset account or an overstatement of a liability account would have the same effect on the income statement.
- D) Either an understatement of an asset account or an overstatement of a liability account would have the same effect on the income statement.

Answer: C

Terms: Effects of misstatements

Diff: Moderate

Objective: LO 9-3

AACSB: Reflective thinking skills

6) Which of the following are major difficulties auditors face when allocating materiality to balance sheet accounts?

A)

Certain accounts contain more misstatements than others	Only overstatements need be considered	Audit costs can affect allocation
Yes	No	Yes

B)

Certain accounts contain more misstatements than others	Only overstatements need be considered	Audit costs can affect allocation
Yes	Yes	No

C)

Certain accounts contain more misstatements than others	Only overstatements need be considered	Audit costs can affect allocation
Yes	Yes	Yes

D)

Certain accounts contain more misstatements than others	Only overstatements need be considered	Audit costs can affect allocation
No	Yes	No

Answer: A

Terms: Major difficulties auditors face when allocating materiality to balance sheet accounts

Diff: Moderate

Objective: LO 9-3

AACSB: Reflective thinking skills

7) When allocating performance materiality:

- A) it is easy to predict in advance which accounts are not likely to be misstated.
- B) only overstatements need to be considered.
- C) professional judgment is critical.
- D) the sum of all the performance materiality levels cannot exceed the preliminary judgment about materiality.

Answer: C

Terms: Major difficulties auditors face when allocating materiality to balance sheet accounts

Diff: Moderate

Objective: LO 9-3

AACSB: Reflective thinking skills

8) When allocating materiality, most practitioners choose to allocate to:

- A) the income statement accounts because they are more important.
- B) the balance sheet accounts because most audits focus on the balance sheet.
- C) both balance sheet and income statement accounts because there could be errors on either.
- D) all of the financial statements because it is required by GAAS.

Answer: B

Terms: Allocating materiality

Diff: Challenging

Objective: LO 9-3

AACSB: Reflective thinking skills

9) Which of the following is a correct statement regarding performance materiality?

- A) Determining performance materiality is necessary because auditors accumulate evidence by segments.
- B) The level of performance materiality does not affect the amount of evidence needed.
- C) Performance materiality cannot vary for different classes of transactions.
- D) Performance materiality is required for public companies, but not for private companies.

Answer: A

Terms: Tolerable misstatements

Diff: Challenging

Objective: LO 9-3

AACSB: Reflective thinking skills

10) Explain why it is necessary to allocate the preliminary judgment about materiality to individual accounts (segments) in the financial statements. Also explain why allocating to balance sheet accounts is more common than allocating to income statement accounts.

Answer: Allocating the preliminary judgment about materiality to individual accounts (segments) is necessary because evidence is accumulated for accounts (segments) rather than for the financial statements as a whole. Allocating to accounts (segments) establishes a tolerable misstatement amount for each account, which helps the auditor decide the appropriate audit evidence to accumulate for each account. Most practitioners allocate materiality to balance sheet accounts rather than income statement accounts because most income statement misstatements have an equal effect on the balance sheet due to the nature of double-entry accounting. Because there are fewer balance sheet accounts than income statement accounts in most audits, and because most audit procedures focus on balance sheet accounts, materiality should be allocated only to balance sheet accounts.

Terms: Allocation of the preliminary judgment about materiality

Diff: Moderate

Objective: LO 9-3

AACSB: Reflective thinking skills

11) Auditor's allocate the preliminary judgment about materiality to financial statement segments rather than by financial statements as a whole. What is the term for the auditor's allocation of preliminary misstatement to account balances? What are three difficulties auditor's face when allocating materiality to balance sheet accounts?

Answer: Performance materiality is the term for the auditor's allocation of the preliminary judgment of materiality to any given account balance. The three difficulties auditors face when allocating the preliminary materiality to account balances are:

1. Auditors expect certain accounts to have more misstatement than others.
2. Both overstatements and understatements must be considered.
3. Audit costs can affect the allocation.

Terms: Allocation of preliminary misstatement to account balances and difficulties that auditors face allocating preliminary materiality judgment to account balances

Diff: Moderate

Objective: LO 9-3

AACSB: Reflective thinking skills

12) Most practitioners allocate the preliminary judgment about materiality to both the balance sheet and income statement accounts.

A) True

B) False

Answer: B

Terms: Allocate preliminary judgment about materiality to balance sheet accounts

Diff: Moderate

Objective: LO 9-3

AACSB: Reflective thinking skills

13) The primary purpose of allocating the preliminary judgment about materiality to financial statement accounts is to help the auditor decide the appropriate evidence to accumulate.

A) True

B) False

Answer: A

Terms: Primary purpose of allocating the preliminary judgment about materiality

Diff: Easy

Objective: LO 9-3

AACSB: Reflective thinking skills

14) Both overstatements and understatements must be considered when allocating materiality to balance sheet accounts.

A) True

B) False

Answer: A

Terms: Allocating materiality; Consideration of overstatements and understatements

Diff: Easy

Objective: LO 9-3

AACSB: Reflective thinking skills

15) If an auditor assigns a tolerable misstatement of \$1,000 to accounts payable, he or she would need to obtain more audit evidence for that account than if \$100,000 had been assigned.

A) True

B) False

Answer: A

Terms: Tolerable misstatements and audit evidence

Diff: Moderate

Objective: LO 9-3

AACSB: Reflective thinking skills

16) To maximize audit efficiency, the auditor should allocate less tolerable misstatement to accounts that can be verified by using low-cost audit procedures, such as analytical procedures, than to accounts that are more costly to audit.

A) True

B) False

Answer: A

Terms: Maximize audit efficiency, allocate less tolerable misstatements

Diff: Moderate

Objective: LO 9-3

AACSB: Reflective thinking skills

Learning Objective 9-4

1) Auditors are _____ to document the known and likely misstatements in the financial statements under audit.

- A) permitted
- B) required
- C) not allowed
- D) strongly encouraged

Answer: B

Terms: Known and likely misstatements in the financial statements

Diff: Easy

Objective: LO 9-4

AACSB: Reflective thinking skills

2) _____ misstatements are those where the auditor can determine the amount of the misstatement in the account.

- A) Potential
- B) Likely
- C) Known
- D) Projected

Answer: C

Terms: Misstatements where auditor can determine the amount

Diff: Moderate

Objective: LO 9-4

AACSB: Reflective thinking skills

3) Likely misstatements can result from:

A)

Computation of the sampling error for the cash account	Differences between management's and an auditor's judgment about account balances	Projections of misstatements based on an auditor's tests of a sample from a population
No	Yes	Yes

B)

Computation of the sampling error for the cash account	Differences between management's and an auditor's judgment about account balances	Projections of misstatements based on an auditor's tests of a sample from a population
Yes	Yes	No

C)

Computation of the sampling error for the cash account	Differences between management's and an auditor's judgment about account balances	Projections of misstatements based on an auditor's tests of a sample from a population
No	No	Yes

D)

Computation of the sampling error for the cash account	Differences between management's and an auditor's judgment about account balances	Projections of misstatements based on an auditor's tests of a sample from a population
Yes	No	No

Answer: A

Terms: Likely misstatements result from

Diff: Moderate

Objective: LO 9-4

AACSB: Reflective thinking skills

- 4) When evaluating the audit findings, the auditor should be satisfied that the:
- A) amount of known misstatement is documented in the management representation letter.
 - B) estimate of the total known and likely misstatements is less than a material amount.
 - C) estimate of the total likely misstatement includes sample error.
 - D) amount of known misstatement is acknowledged and recorded by the client.

Answer: B

Terms: Evaluating audit findings and materiality

Diff: Challenging

Objective: LO 9-4

AACSB: Reflective thinking skills

- 5) Discuss each of the five steps in applying materiality in an audit, and identify the audit phase(s) in which each step is performed. List these steps in the order in which they occur.

Answer:

Step 1. Set preliminary judgment about materiality. This is the combined amount of misstatements in the financial statements that would be considered material. This decision is made in the planning stage of the audit.

Step 2. Allocate preliminary judgment about materiality to segments. In this step, the auditor normally allocates the preliminary judgment about materiality to the balance sheet accounts. The amount of materiality allocated to an account is referred to as that account's performance materiality. This allocation is performed in the audit planning stage.

Step 3. Estimate total misstatement in segment. In this step, the auditor projects the sample results to the population. An allowance for sampling risk is also calculated. This would be performed after the substantive tests for each account are completed.

Step 4. Estimate the combined misstatement. In this step, the projected errors for each account are added, along with total sampling error, to calculate the combined misstatement. This would be performed after all substantive tests have been completed.

Step 5. Compare combined estimated misstatement with preliminary or revised judgment about materiality. If the combined estimated misstatement is less than or equal to the judgment about materiality, then the auditor concludes the financial statements are fairly presented. This would be performed after all substantive tests have been completed, in the final review stage of the audit.

Terms: Five steps in applying materiality in audit

Diff: Challenging

Objective: LO 9-2, LO 9-3, and LO 9-4

AACSB: Reflective thinking skills

- 6) The preliminary judgment on materiality is compared to the total estimated misstatement amount to determine if an account balance is materially misstated.

A) True

B) False

Answer: A

Terms: Preliminary judgment on materiality; Estimated total misstatements

Diff: Moderate

Objective: LO 9-4

AACSB: Reflective thinking skills

7) Total estimated misstatements include known misstatements and projected misstatements plus a sampling error.

A) True

B) False

Answer: A

Terms: Total estimated misstatements and sampling error

Diff: Moderate

Objective: LO 9-4

AACSB: Reflective thinking skills

8) If the total misstatement of an account is known, a sampling error still needs to be determined.

A) True

B) False

Answer: B

Terms: Total estimated misstatements and sampling error

Diff: Moderate

Objective: LO 9-4

AACSB: Reflective thinking skills

9) Sampling error represents the minimum misstatement amount that exists in all accounts subjected to sampling.

A) True

B) False

Answer: B

Terms: Total estimated misstatements and sampling error

Diff: Moderate

Objective: LO 9-4

AACSB: Reflective thinking skills

10) If the auditor approaches the audit of the accounts in a sequential manner, the findings of the audit of accounts audited earlier can be used to revise the performance materiality established for accounts audited later.

A) True

B) False

Answer: A

Terms: Total estimated misstatements and sampling error

Diff: Moderate

Objective: LO 9-4

AACSB: Reflective thinking skills

Learning Objective 9-5

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

A)

Control Risk	Inherent Risk	Detection Risk
Yes	Yes	Yes

B)

Control Risk	Inherent Risk	Detection Risk
Yes	Yes	No

C)

Control Risk	Inherent Risk	Detection Risk
No	No	Yes

D)

Control Risk	Inherent Risk	Detection Risk
No	No	No

Answer: A

Terms: Audit risk components assessed in non-quantitative terms

Diff: Easy

Objective: LO 9-5

AACSB: Reflective thinking skills

2) Based on audit evidence gathered and evaluated, an auditor decides to increase the assessed level of control risk from that originally planned. To achieve an overall audit risk level that is substantially the same as the planned audit risk level, the auditor would:

A) increase materiality levels.

B) decrease detection risk.

C) decrease substantive testing.

D) increase inherent risk.

Answer: B

Terms: Control risk and planned audit risk model

Diff: Challenging

Objective: LO 9-5

AACSB: Reflective thinking skills

3) When dealing with audit risk:

- A) auditors accept some level of risk in performing the audit function.
- B) most risks that auditors encounter are relatively easy to measure.
- C) the audit risk model is only used for classes of transactions.
- D) most audit firms prefer to use a quantitative assessment for risk.

Answer: A

Terms: Audit risk

Diff: Moderate

Objective: LO 9-2 and LO 9-5

AACSB: Reflective thinking skills

4) Why do auditors use the audit risk model when planning an audit?

Answer: The audit risk model is used primarily for planning purposes in deciding how much evidence to accumulate in each cycle. The auditor sets an acceptable level of audit risk, (AAR) assesses inherent risk (IR) and control risk (CR), and then uses the following audit risk model to determine an appropriate level of planned detection risk (PDR):

$$PDR = \frac{AAR}{IR \times CR}$$

Terms: Audit risk model

Diff: Easy

Objective: LO 9-5

AACSB: Reflective thinking skills

5) The most important element of the audit risk model is control risk.

A) True

B) False

Answer: B

Terms: Audit risk model and control risk

Diff: Easy

Objective: LO 9-5

AACSB: Reflective thinking skills

6) The audit risk model that must be used for planning audit procedures and evaluating audit results is:

$$\frac{DR}{IR \times CR} = AAR.$$

A) True

B) False

Answer: B

Terms: Audit risk model

Diff: Moderate

Objective: LO 9-5

AACSB: Reflective thinking skills

Learning Objective 9-6

1) The measurement of the auditor's assessment of the likelihood that there are material misstatements due to error or fraud in a segment before considering the effectiveness of internal controls is defined as:

- A) audit risk.
- B) inherent risk.
- C) sampling risk.
- D) detection risk.

Answer: B

Terms: Assessment of likelihood of material misstatements due to error or fraud

Diff: Easy

Objective: LO 9-6

AACSB: Reflective thinking skills

2) The risk that audit evidence for a segment will fail to detect misstatements exceeding performance materiality levels is:

- A) audit risk.
- B) control risk.
- C) inherent risk.
- D) planned detection risk.

Answer: D

Terms: Risk audit evidence will fail to detect misstatements

Diff: Moderate

Objective: LO 9-6

AACSB: Reflective thinking skills

3) As the risk of material misstatement increases, detection risk should:

- A) medium increase.
- B) decrease.
- C) stay the same.
- D) Is indeterminate.

Answer: B

Terms: Risk of material misstatement increases, detection risk

Diff: Moderate

Objective: LO 9-6

AACSB: Reflective thinking skills

4) Inherent risk is _____ related to detection risk and _____ related to the amount of audit evidence.

- A) directly, inversely
- B) directly, directly
- C) inversely, inversely
- D) inversely, directly

Answer: D

Terms: Relationship of inherent risk, detection risk, and amount of audit evidence

Diff: Moderate

Objective: LO 9-6

AACSB: Reflective thinking skills

5) Auditors frequently refer to the terms audit assurance, overall assurance, and level of assurance to refer to _____.

- A) detection risk
- B) audit report risk
- C) acceptable audit risk
- D) inherent risk

Answer: C

Terms: Audit assurance, overall assurance and level of assurance

Diff: Moderate

Objective: LO 9-6

AACSB: Reflective thinking skills

6) If planned detection risk is reduced, the amount of evidence the auditor accumulates will:

- A) increase.
- B) decrease.
- C) remain unchanged.
- D) be indeterminate.

Answer: A

Terms: Assess control risk

Diff: Moderate

Objective: LO 9-6

AACSB: Reflective thinking skills

7) Planned detection risk

- I. determines the amount of substantive evidence the auditor plans to accumulate.
- II. is dependent on inherent risk and business risk.

- A) I only
- B) II only
- C) I and II
- D) None of the above

Answer: A

Terms: Planned detection risk

Diff: Moderate

Objective: LO 9-6

AACSB: Reflective thinking skills

8) Inherent risk is often high for an account such as:

- A) inventory.
- B) land.
- C) capital stock.
- D) notes payable.

Answer: A

Terms: Inherent risk

Diff: Moderate

Objective: LO 9-6

AACSB: Reflective thinking skills

9) Inherent risk and control risk:

- A) are inversely related to each other.
- B) are inversely related to detection risk.
- C) are directly related to detection risk.
- D) are directly related to audit risk.

Answer: B

Terms: Inherent risk and control risk

Diff: Moderate

Objective: LO 9-6

AACSB: Reflective thinking skills

10) To what extent do auditors typically rely on internal controls of their public company clients?

- A) Extensively
- B) Only very little
- C) Infrequently
- D) Never

Answer: A

Terms: Extent auditor rely on internal controls of public company client

Diff: Moderate

Objective: LO 9-6

AACSB: Reflective thinking skills

Topic: Public

11) Auditors typically rely on internal controls of their private company clients:

- A) only as needed to complete the audit and satisfy Sarbanes-Oxley requirements.
- B) only if the controls are determined to be effective.
- C) only if the client asks an auditor to test controls.
- D) only if the controls are sufficient to increase Control Risk to an acceptable level.

Answer: B

Terms: Extent auditor rely on internal controls of private company client

Diff: Moderate

Objective: LO 9-6

AACSB: Reflective thinking skills

12) Which is a true statement about audit risk?

- A) Audit risk measures the risk that a material misstatement could occur and not be detected by internal control.
- B) When auditors decide on a higher acceptable audit risk, they want to be more certain that the financial statements are not materially misstated.
- C) Audit assurance is the complement of acceptable audit risk.
- D) There is an inverse relationship between acceptable audit risk and planned detection risk.

Answer: C

Terms: Acceptable audit risk

Diff: Challenging

Objective: LO 9-6

AACSB: Reflective thinking skills

13) The risk of material misstatement refers to:

- A) control risk and acceptable audit risk.
- B) inherent risk.
- C) the combination of inherent risk and control risk.
- D) inherent risk and audit risk.

Answer: C

Terms: Risk of material misstatements

Diff: Challenging

Objective: LO 9-6

AACSB: Reflective thinking skills

14) When assessing risk, it is important to remember that:

- A) for acceptable audit risk, the SEC decides the risk the CPA firm should take for public clients.
- B) inherent risk can be changed by the auditor.
- C) detection risk can only be determined after audit risk, inherent risk, and control risk are determined.
- D) control risk is determined by company management since they are responsible for internal control.

Answer: C

Terms: Difference between material misstatement and detection risk

Diff: Challenging

Objective: LO 9-6

AACSB: Reflective thinking skills

15) Auditors may assess inherent risk and control risk:

A)

Jointly to determine the risk of material misstatement	Separately and combine their effects in the audit risk model
Yes	Yes

B)

Jointly to determine the risk of material misstatement	Separately and combine their effects in the audit risk model
No	No

C)

Jointly to determine the risk of material misstatement	Separately and combine their effects in the audit risk model
Yes	No

D)

Jointly to determine the risk of material misstatement	Separately and combine their effects in the audit risk model
No	Yes

Answer: A

Terms: Auditor may assess inherent risk and control risk

Diff: Challenging

Objective: LO 9-6

AACSB: Reflective thinking skills

16) In a financial statement audit, inherent risk is evaluated to help an auditor assess which of the following?

A) The internal audit department's objectivity in reporting a material misstatement of a financial statement assertion it detects to the audit committee

B) The risk the internal control system will not detect a material misstatement of a financial statement assertion

C) The risk that the audit procedures implemented will not detect a material misstatement of a financial statement assertion

D) The susceptibility of a financial statement assertion to a material misstatement assuming there are no related controls

Answer: D

Terms: Inherent risk assessment

Diff: Challenging

Objective: LO 9-6

AACSB: Reflective thinking skills

17) Which of the following statements is **not** true?

- A) Inherent risk is inversely related to the amount of audit evidence whereas detection risk is directly related to the amount of audit evidence required.
- B) Inherent risk is directly related to evidence whereas detection risk is inversely related to the amount of audit evidence required.
- C) Inherent risk is the susceptibility of the financial statements to material error, assuming no internal controls.
- D) Inherent risk and control risk are assessed by the auditor and function independently of the financial statement audit.

Answer: A

Terms: Inherent risk

Diff: Challenging

Objective: LO 9-6

AACSB: Reflective thinking skills

18) An auditor who audits a business cycle that has low inherent risk should:

- A) increase the amount of audit evidence gathered.
- B) assign more experienced staff to that area.
- C) increase the performance materiality level for the area.
- D) expand planning procedures.

Answer: C

Terms: Low inherent risk

Diff: Easy

Objective: LO 9-5

AACSB: Reflective thinking skills

19) Match the terms below (a-h) with the definitions provided below (1-8):

- a. Preliminary judgment about materiality
- b. Inherent risk
- c. Planned detection risk
- d. Audit assurance
- e. Acceptable audit risk
- f. Performance materiality level
- g. Control risk
- h. Materiality

_____ 1. A measure of the risk that audit evidence for a segment will fail to detect misstatements exceeding the performance materiality amount, should such misstatements exist.

_____ 2. A measure of the auditor's assessment of the likelihood that misstatements exceeding a performance materiality in a segment will not be prevented or detected by the client's internal controls.

_____ 3. A measure of how much risk the auditor is willing to take that the financial statements may be materially misstated after the audit is completed and an unqualified audit opinion has been issued.

_____ 4. The materiality allocated to any given account balance.

_____ 5. The maximum amount by which the auditor believes that the statements could be misstated and still not affect the decisions of reasonable users.

_____ 6. This term is synonymous with acceptable audit risk.

_____ 7. The magnitude of an omission or misstatement of accounting information that makes it probable that the judgment of a reasonable person would have been changed.

_____ 8. A measure of the auditor's assessment of the likelihood that there are material misstatements before considering the effectiveness of internal control.

Answer:

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

Terms: Business risk; Control risk; Acceptable audit risk; Materiality; Audit assurance; Preliminary judgment about materiality; Tolerable misstatement;

Diff: Moderate

Objective: LO 9-1, LO 9-2, LO 9-3, and LO 9-6

AACSB: Reflective thinking skills

20) Using your knowledge of the relationships among acceptable audit risk, inherent risk, control risk, planned detection risk, performance materiality, and planned evidence, state the effect on planned evidence (increase or decrease) of changing each of the following factors, while the other factors remain unchanged.

1. An increase in acceptable audit risk. _____.
2. An increase in inherent risk. _____.
3. A decrease in control risk. _____.
4. An increase in planned detection risk. _____.
5. An increase in performance materiality. _____.

Answer:

1. decrease
2. increase
3. decrease
4. decrease
5. decrease

Terms: Relationships among acceptable audit risk, inherent risk, control risk, planned detection risk, and tolerable misstatement with planned evidence

Diff: Moderate

Objective: LO 9-3, LO 9-4 and LO 9-6

AACSB: Analytic skills

21) If acceptable audit risk is low, and inherent risk and control risk are both low, then planned detection risk should be high.

- A) True
- B) False

Answer: A

Terms: Relationship of acceptable audit risk, inherent risk, control risk, and planned detection risk.

Diff: Easy

Objective: LO 9-5 and LO 9-6

AACSB: Reflective thinking skills

22) If the audit assurance rate is 95%, then the level of acceptable audit risk is 5%.

- A) True
- B) False

Answer: A

Terms: Audit risk

Diff: Moderate

Objective: LO 9-3 and LO 9-6

AACSB: Reflective thinking skills

23) A high detection risk equates to a low amount of audit evidence needed.

A) True

B) False

Answer: B

Terms: Detection risk and amount of evidence needed

Diff: Easy

Objective: LO 9-6

AACSB: Reflective thinking skills

24) For a private company client, auditors are required to test any internal controls they believe have not been operating effectively during the period under audit.

A) True

B) False

Answer: B

Terms: Auditors required to test internal controls for private companies

Diff: Easy

Objective: LO 9-6

AACSB: Reflective thinking skills

25) There is a direct relationship between acceptable audit risk and planned detection risk.

A) True

B) False

Answer: A

Terms: Inherent risk and control risk

Diff: Moderate

Objective: LO 9-6

AACSB: Reflective thinking skills

26) Acceptable audit risk and the amount of substantive evidence required are inversely related.

A) True

B) False

Answer: A

Terms: Acceptable audit risk and substantive evidence

Diff: Moderate

Objective: LO 9-6

AACSB: Reflective thinking skills

27) As control risk increases, the amount of substantive evidence the auditor plans to accumulate should increase.

A) True

B) False

Answer: A

Terms: Control risk and substantive evidence

Diff: Moderate

Objective: LO 9-6

AACSB: Reflective thinking skills

28) Inherent risk and control risk are directly related.

A) True

B) False

Answer: B

Terms: Inherent risk and control risk

Diff: Moderate

Objective: LO 9-6

AACSB: Reflective thinking skills

29) An acceptable audit risk assessment of low indicates a risky client requiring more extensive evidence, assignment of more experienced personnel, and/or a more extensive review of audit files.

A) True

B) False

Answer: A

Terms: Acceptable audit risk

Diff: Moderate

Objective: LO 9-6

AACSB: Reflective thinking skills

30) Audit assurance is the complement of planned detection risk, that is, one minus planned detection risk.

A) True

B) False

Answer: B

Terms: Audit assurance and planned detection risk

Diff: Moderate

Objective: LO 9-6

AACSB: Reflective thinking skills

Learning Objective 9-7

1) If an auditor believes the chance of financial failure is high and there is a corresponding increase in business risk for the auditor, acceptable audit risk would likely:

A) be reduced.

B) be increased.

C) remain the same.

D) be calculated using a computerized statistical package.

Answer: A

Terms: Increase in business risk, acceptable audit risk

Diff: Moderate

Objective: LO 9-7

AACSB: Reflective thinking skills

2) When management has an adequate level of integrity for the auditor to accept the engagement but cannot be regarded as completely honest in all dealings, auditors normally:

- A) reduce acceptable audit risk and increase inherent risk.
- B) reduce inherent risk and control risk.
- C) increase inherent risk and control risk.
- D) increase acceptable audit risk and reduce inherent risk.

Answer: A

Terms: Management integrity

Diff: Moderate

Objective: LO 9-7

AACSB: Reflective thinking skills

3) When the auditor is attempting to determine the extent to which external users rely on a client's financial statements, they may consider several factors **except** for:

- A) client size.
- B) concentration of ownership.
- C) nature and amounts of liabilities.
- D) assessment of detection risk.

Answer: D

Terms: Extent to which external users rely on client's financial statements

Diff: Moderate

Objective: LO 9-7

AACSB: Reflective thinking skills

4) There are several factors that affect an audit firm's business risk and, therefore, acceptable audit risk. Discuss three of these factors.

Answer: Business risk and acceptable audit risk are affected by:

- *The degree to which external users will rely on the statements.* For large, publicly held clients, business risk is greater, and acceptable audit risk will be less, than for small, privately held clients, all things being equal.
- *The likelihood that a client will have financial difficulties after the audit report is issued.* Business risk is greater, and acceptable audit risk will be lower, when the client is experiencing financial difficulties.
- *The auditor's evaluation of management's integrity.* Business risk is greater and acceptable audit risk will be lower when the client's management has questionable integrity.

Terms: Factors that affect business risk and acceptable audit risk

Diff: Moderate

Objective: LO 9-7

AACSB: Reflective thinking skills

5) Describe the audit risk model and each of its components.

Answer: The planning form of the audit risk model is stated as follows:

$$\text{PDR} = \frac{\text{AAR}}{\text{IR} \times \text{CR}}$$

where: PDR = planned detection risk
AAR = acceptable audit risk
IR = inherent risk
CR = control risk

Planned detection risk is a measure of the risk that audit evidence for an account (segment) will fail to detect misstatements exceeding a tolerable amount, should such misstatements exist. Planned detection risk determines the amount of substantive evidence that the auditor plans to accumulate.

Acceptable audit risk is a measure of how willing the auditor is to accept that the financial statements may be materially misstated after the audit is completed and an unqualified opinion has been issued. It is influenced primarily by the degree to which external users will rely on the statements, the likelihood that a client will have financial difficulties after the audit report is issued, and the auditor's evaluation of management's integrity.

Inherent risk is a measure of the auditor's assessment of the likelihood that there are material misstatements in an account due to error or fraud before considering the effectiveness of internal control.

Control risk is a measure of the auditor's assessment of the likelihood that misstatements exceeding a tolerable amount in an account (segment) will be prevented or detected on a timely basis by the client's internal controls.

Terms: Audit risk model

Diff: Moderate

Objective: LO 9-5, LO 9-6, and LO 9-7

AACSB: Reflective thinking skills

6) If an auditor believes the client will have financial difficulties after the audit report is issued, and external users will be relying heavily on the financial statements, the auditor will probably set acceptable audit risk as low.

A) True

B) False

Answer: A

Terms: Auditor believes client will have financial difficulties after audit report is issued;

External users rely heavily on financial statements

Diff: Moderate

Objective: LO 9-7

AACSB: Reflective thinking skills

7) Engagement risk is effectively the audit firm's business risk.

- A) True
- B) False

Answer: A

Terms: Engagement risk and business risk

Diff: Moderate

Objective: LO 9-7

AACSB: Reflective thinking skills

Learning Objective 9-8

1) Which of the following statements regarding inherent risk is **correct**?

- A) Inherent risk is unaffected by the auditor's experience with client's organization.
- B) Most auditors set a low inherent risk in the first year of an audit and increase it if experience shows that it was incorrect.
- C) Most auditors set a high inherent risk in the first year of an audit and reduce it in subsequent years as they gain more knowledge about the company.
- D) Inherent risk is dependent upon the strengths in client's internal control system.

Answer: C

Terms: Inherent risk

Diff: Easy

Objective: LO 9-8

AACSB: Reflective thinking skills

2) Auditors begin their assessments of inherent risk during audit planning. Which of the following would **not** help in assessing inherent risk during the planning phase?

- A) Obtaining client's agreement on the engagement letter
- B) Obtaining knowledge about the client's business and industry
- C) Touring the client's plant and offices
- D) Identifying related parties

Answer: A

Terms: Assessment of inherent risk during audit planning

Diff: Easy

Objective: LO 9-8

AACSB: Reflective thinking skills

3) Which of the following is **not** a primary consideration when assessing inherent risk?

- A) Nature of client's business
- B) Existence of related parties
- C) Degree of separation of duties
- D) Susceptibility to misappropriation of assets

Answer: C

Terms: Assessing inherent risk

Diff: Challenging

Objective: LO 9-8

AACSB: Reflective thinking skills

4) Harker, CPA is in the audit planning phase of Dracule Industries. An understanding needs to be established regarding the responsibilities of Harker and Dracule's Management. For each of the task items listed below indicate the responsible party from the list of choices given. Each choice may be used once, more than once or not at all.

Task to be performed:	Responsible Party:
1. Obtain an understanding of internal controls	a. Auditor is responsible
2. Preparation of the financial statements	b. Management is responsible
3. Assess inherent risk	c. Both are responsible
4. Following GAAP or IFRS	d. Neither are responsible
5. Detect Material Error	
6. Comply with laws and regulations	
7. Assess the risk of the allowance for doubtful accounts estimate	
8. Determine the known and likely errors or misstatements	

Answer:

1. a
2. b
3. a
4. c
5. a
6. b
7. c
8. a

Terms: Responsible parties

Diff: Moderate

Objective: LO 9-1, LO 9-2, LO 9-3, LO 9-4, LO 9-5, LO 9-6, LO 9-7, and LO 9-8

AACSB: Reflective thinking skills

5) The risk of material misstatement is a combination of two client controlled factors: inherent risk and control risk. What is inherent risk, why is it important and give examples of inherent risk factors.

Answer: Inherent risk is the auditor's assessment of the likelihood that there are material misstatements in the audit segment before the consideration of internal controls. Inherent risk is important because it attempts to predict where misstatements are most and least likely to occur. Factors that the auditor considers when assessing inherent risk include but are not limited to:

- The nature of the client's business
- Results of previous audits
- Initial versus repeat engagements
- Related parties
- Complex or nonroutine transactions
- Judgment required to correctly record account balances and transactions
- Makeup of the population
- Factors related to fraudulent financial reporting
- Factors related to misappropriation of assets

Terms: Factors affecting inherent risk

Diff: Easy

Objective: LO 9-8

AACSB: Reflective thinking skills

6) The risk of fraud should be assessed for the entire audit as well as by cycle, account, and objective.

A) True

B) False

Answer: A

Terms: Fraud

Diff: Moderate

Objective: LO 9-8

AACSB: Reflective thinking skills

7) The auditing profession has established guidelines for setting inherent risk.

A) True

B) False

Answer: B

Terms: Inherent risk

Diff: Moderate

Objective: LO 9-8

AACSB: Reflective thinking skills

8) Auditors begin their assessment of inherent risk during the planning phase and update the assessments throughout the audit.

A) True

B) False

Answer: A

Terms: Inherent risk

Diff: Moderate

Objective: LO 9-8

AACSB: Reflective thinking skills

Learning Objective 9-9

1) As the acceptable level of detection risk increases, an auditor may change the:

A) timing of substantive tests by performing them at an interim date rather than year end.

B) timing of the tests on controls by performing them throughout the year rather than at one time.

C) assess the level of inherent risk to a lower amount.

D) increase the sample size to achieve a more effective test.

Answer: A

Terms: Detection risk

Diff: Moderate

Objective: LO 9-9

AACSB: Reflective thinking skills

2) Auditors respond to risk primarily by:

I. changing the extent of testing.

II. changing the types of audit procedures.

A) I only

B) II only

C) I and II

D) neither I nor i

Answer: C

Terms: Risk assessment procedures

Diff: Moderate

Objective: LO 9-9

AACSB: Reflective thinking skills

3) In practice, auditors rarely assign numerical probabilities to inherent risk, control risk, or acceptable audit risk. It is more common to assess these risks as high, medium, or low. For each of the four situations below, fill in the blanks for planned detection risk and the amount of evidence you would plan to gather ("planned evidence") using the terms high, medium, or low.

	SITUATION 1	SITUATION 2	SITUATION 3	SITUATION 4
Acceptable audit risk	Low	Low	High	High
Inherent risk	High	Low	Low	Low
Control risk	High	Low	Medium	Low
Planned detection risk	_____	_____	_____	_____
Planned evidence	_____	_____	_____	_____

Answer:

1. low, high
2. medium, medium
3. medium, medium
4. high, low

Terms: Planned detection risk and planned evidence in relation to acceptable audit risk, inherent risk, and control risk

Diff: Moderate

Objective: LO 9-9

AACSB: Analytic skills

4) Dracule Industries is a privately owned business that sells medical product and devices to hospitals, clinics and the public. Certain changes have occurred in Dracule Industries during the year undergoing the audit. Harker needs to evaluate the effect these changes have on audit risk. Audit risk at the financial statement level is influenced by the risk of material misstatement; which include factors related to management, the industry and the entity or a combination thereof. For each of the following changes that have occurred during the year under audit identify the appropriate audit response for the list of responses. Each response can be used once, more than once or not at all.

<p>Client changes:</p> <ol style="list-style-type: none"> 1. An internal audit department has been established. 2. A new inventory control system has been installed that reduces the access of unauthorized parties. 3. Inexperienced accounting personnel were hired in the accounting department. 4. Excess cash was used to purchase complex derivatives. 5. Controls over the sales credit approval process have laxed. 6. New government regulations now apply to Dracule Industries. 7. Management has become overly aggressive in reaching target goals. 8. An expert was hired to help determine the value of the ore content in ending materials inventory. 	<p>Possible effect on the audit:</p> <ol style="list-style-type: none"> a. Increase the acceptable level of detection risk. b. Decrease the acceptable level of detection risk. c. Change has no effect on the acceptable level of detection risk.
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Answer:

1. a
2. a
3. b
4. b
5. b
6. b
7. b
8. a

Terms: Audit risk

Diff: Moderate

Objective: LO 9-6, LO 9-7, LO 9-8, and LO 9-9

AACSB: Analytic skills

5) In applying the audit risk model, auditors are concerned about overstatements, not understatements.

A) True

B) False

Answer: B

Terms: Audit risk model

Diff: Easy

Objective: LO 9-9

AACSB: Reflective thinking skills

6) One major limitation in the application of the audit risk model is the difficulty of measuring the components of the model.

A) True

B) False

Answer: A

Terms: Audit risk

Diff: Easy

Objective: LO 9-9

AACSB: Reflective thinking skills

Learning Objective 9-10

1) When taken together, the concepts of risk and materiality in auditing:

A) measure the uncertainty of amounts of a given magnitude.

B) measure uncertainty only.

C) measure magnitude only.

D) measure inherent risk.

Answer: A

Terms: Materiality and risk

Diff: Moderate

Objective: LO 9-10

AACSB: Reflective thinking skills

2) Which of the following is a correct statement?

A) The audit risk model helps in evaluating results.

B) Special care must be exercised when the auditor decides on the basis of accumulated evidence that the original assessment of control risk was understated.

C) The auditor violates due care if he knows that the original assessment of audit risk is inappropriate and he fails to change it.

D) Performance materiality is part of the audit risk model.

Answer: C

Terms: Risk assessment procedures

Diff: Moderate

Objective: LO 9-10

AACSB: Reflective thinking skills