

Auditing and Assurance Services, 15e, Global Edition (Arens)
Chapter 24 Audit Completion

Learning Objective 24-1

1) Auditors often integrate procedures for presentation and disclosure objectives with:

A)

Tests for planning objectives	Tests for balance-related objectives
Yes	Yes

B)

Tests for planning objectives	Tests for balance-related objectives
No	No

C)

Tests for planning objectives	Tests for balance-related objectives
Yes	No

D)

Tests for planning objectives	Tests for balance-related objectives
No	Yes

Answer: D

Terms: Procedures for presentation and disclosure objectives

Diff: Easy

Objective: LO 24-1

AACSB: Reflective thinking skills

2) The auditor's primary concern relative to presentation and disclosure-related objectives is:

A) accuracy.

B) existence.

C) completeness.

D) occurrence.

Answer: C

Terms: Presentation and disclosure-related objectives

Diff: Easy

Objective: LO 24-1

AACSB: Reflective thinking skills

Learning Objective 24-2

1) If a potential loss on a contingent liability is remote, the liability usually is:

A) disclosed in footnotes, but not accrued.

B) neither accrued nor disclosed in footnotes.

C) accrued and indicated in the body of the financial statements.

D) disclosed in the auditor's report but not disclosed on the financial statements.

Answer: B

Terms: Contingent liability; remote

Diff: Easy

Objective: LO 24-2

AACSB: Reflective thinking skills

2) A commitment is best described as:

A) an agreement to commit the firm to a set of fixed conditions in the future.

B) an agreement to commit the firm to a set of fixed conditions in the future that depends on company profitability.

C) an agreement to commit the firm to a set of fixed conditions in the future that depends on current market conditions.

D) a potential future obligation to an outside party for an as yet to be determined amount.

Answer: A

Terms: Commitments

Diff: Easy

Objective: LO 24-2

AACSB: Reflective thinking skills

3) Which of the following groups has the responsibility for identifying and deciding the appropriate accounting treatment for recording or disclosing contingent liabilities?

A) Auditors

B) Legal counsel

C) Management

D) Management and the auditors

Answer: C

Terms: Recording or disclosing contingent liabilities

Diff: Easy

Objective: LO 24-2

AACSB: Reflective thinking skills

4) You are auditing Rodgers and Company. You are aware of a potential loss due to non-compliance with environmental regulations. Management has assessed that there is a 40% chance that a \$10M payment could result from the non-compliance. The appropriate financial statement treatment is to:

A) accrue a \$4 million liability.

B) disclose a liability and provide a range of outcomes.

C) since there is less than a 50% chance of occurrence, ignore.

D) since there is greater than a remote chance of occurrence, accrue the \$10 million.

Answer: B

Terms: Potential loss for noncompliance

Diff: Moderate

Objective: LO 24-2

AACSB: Analytic skills

5) Which of the following is a contingent liability with which an auditor is particularly concerned?

A)

Notes receivable discounted	Product warranties
Yes	Yes

B)

Notes receivable discounted	Product warranties
No	No

C)

Notes receivable discounted	Product warranties
Yes	No

D)

Notes receivable discounted	Product warranties
No	Yes

Answer: A

Terms: Contingent liability; auditor particularly concerned

Diff: Easy

Objective: LO 24-2

AACSB: Reflective thinking skills

6) Audit procedures related to contingent liabilities are initially focused on:

- A) accuracy.
- B) completeness.
- C) existence.
- D) occurrence.

Answer: D

Terms: Audit procedures related to contingent liabilities

Diff: Easy

Objective: LO 24-2

AACSB: Reflective thinking skills

7) With which of the following client personnel would it generally **not** be appropriate to inquire about commitments or contingent liabilities?

- A) Controller
- B) President
- C) Accounts receivable clerk
- D) Vice president of sales

Answer: C

Terms: Inquire for commitments or contingent liabilities

Diff: Easy

Objective: LO 24-2

AACSB: Reflective thinking skills

8) Inquiries of management regarding the possibility of unrecorded contingencies will be useful in uncovering:

A)

Management's intentional failure to disclose existing contingencies.	When management does not comprehend accounting disclosure requirements.
Yes	Yes

B)

Management's intentional failure to disclose existing contingencies.	When management does not comprehend accounting disclosure requirements.
No	No

C)

Management's intentional failure to disclose existing contingencies.	When management does not comprehend accounting disclosure requirements.
Yes	No

D)

Management's intentional failure to disclose existing contingencies.	When management does not comprehend accounting disclosure requirements.
No	Yes

Answer: D

Terms: Inquiries of management; Unrecorded contingencies

Diff: Easy

Objective: LO 24-2

AACSB: Reflective thinking skills

9) Which of the following is **not** considered a commitment?

A) Agreements to purchase raw materials

B) Pension plans

C) Agreements to lease facilities at set prices

D) Each of the above is a commitment.

Answer: D

Terms: Commitments

Diff: Moderate

Objective: LO 24-2

AACSB: Reflective thinking skills

10) If an auditor concludes there are contingent liabilities, then he or she must evaluate the:

A)

Materiality of the potential liability.	Nature of the disclosure to be included in the financial statements.
Yes	Yes

B)

Materiality of the potential liability.	Nature of the disclosure to be included in the financial statements.
No	No

C)

Materiality of the potential liability.	Nature of the disclosure to be included in the financial statements.
Yes	No

D)

Materiality of the potential liability.	Nature of the disclosure to be included in the financial statements.
No	Yes

Answer: A

Terms: Contingent liabilities

Diff: Moderate

Objective: LO 24-2

AACSB: Reflective thinking skills

11) One of the primary approaches in dealing with uncertainties in loss contingencies uses a _____ threshold.

A) monetary

B) materiality

C) probability

D) analytical

Answer: C

Terms: Contingent liabilities

Diff: Moderate

Objective: LO 24-2

AACSB: Reflective thinking skills

12) If the auditor concludes that there are contingent liabilities, he or she must evaluate the significance of the potential liability and the nature of the disclosure needed in the financial statements. Which of the following statements is **not** true?

A) The potential liability is sufficiently well known in some instances to be included in the financial statements as an actual liability.

B) Disclosure may be unnecessary if the contingency is highly remote or immaterial.

C) A CPA firm often obtains a separate evaluation of the potential liability from its own legal counsel rather than relying on management or management's attorneys.

D) The client's attorneys must remain independent when evaluating the likelihood of losing the lawsuit.

Answer: D

Terms: Contingent liabilities; significance of potential liability; nature of disclosure

Diff: Challenging

Objective: LO 24-2

AACSB: Reflective thinking skills

13) When using the probability threshold for contingencies, the likelihood of the occurrence of the event is classified as:

A) not likely, likely, or highly likely.

B) remote, reasonably possible, or probable.

C) slight, moderate, great.

D) remote, likely, possible.

Answer: B

Terms: Contingent liabilities

Diff: Easy

Objective: LO 24-2

AACSB: Reflective thinking skills

14) When dealing with contingencies:

A) all material contingencies must be disclosed or footnoted.

B) the auditor must exercise considerable professional judgment when evaluating whether the client has applied the appropriate treatment.

C) it is easy for the auditor to uncover contingencies without management's cooperation.

D) the review for contingent liabilities is only performed at the beginning and the end of the audit.

Answer: B

Terms: Contingent liabilities

Diff: Moderate

Objective: LO 24-2

AACSB: Reflective thinking skills

15) Which of the following is **not** a common audit procedure used to search for contingent liabilities?

- A) Examine letters of credit.
- B) Examine payroll reports.**
- C) Review internal revenue agent reports.
- D) Analyze legal expense.

Answer: B

Terms: Contingent liabilities

Diff: Moderate

Objective: LO 24-2

AACSB: Reflective thinking skills

16) Contingent liability disclosure in the footnotes of the financial statements would normally be made when:

- A) the outcome of the accounting event is deemed probable, but a reasonable estimation as to the amount cannot be made by the client or auditor.**
- B) a reasonable estimation of the loss can be made, but the outcome is not probable.
- C) the outcome of the accounting event is deemed probable, and a reasonable estimation as to the amount can be made.
- D) the outcome of the accounting event as well as a reasonable estimation of the loss cannot be made.

Answer: A

Terms: Contingent liability disclosure

Diff: Challenging

Objective: LO 24-2

AACSB: Reflective thinking skills

17) Distinguish between contingent liabilities and commitments.

Answer: Contingent liabilities are potential future obligations to an outside party for an unknown amount resulting from activities that have already taken place. Commitments are agreements that an entity will hold to a fixed set of conditions in the future regardless of what happens to profits or the economy as a whole.

Terms: Contingent liabilities; commitments

Diff: Easy

Objective: LO 24-2

AACSB: Reflective thinking skills

18) Define the term contingent liability and discuss the criteria accountants and auditors use to classify these accounting events.

Answer: Contingent liability: a potential future obligation to an outside party for an unknown amount resulting from activities that have already taken place. Three conditions are required for a contingent liability to exist: (1) there is a potential future payment to an outside party or the impairment of an asset that resulted from an existing condition; (2) there is uncertainty about the amount for the future payment or impairment; and (3) the outcome will be resolved by some future event or events. Accounting standards describe three levels of likelihood of occurrence and the appropriate financial statement treatment for each likelihood as follows:

- a. Probable—future event likely to occur and amount can be reasonably estimated then the financial statement accounts are adjusted. If amount cannot be reasonably estimated, then a footnote disclosure is necessary.
- b. Reasonably possible—chance of occurring is more than remote, but less than probable. Footnote disclosure is necessary.
- c. Remote—chance of occurrence is slight, no disclosure is necessary.

Terms: Contingent liabilities

Diff: Easy

Objective: LO 24-2

AACSB: Reflective thinking skills

19) With what types of contingencies might an auditor be concerned?

Answer: The auditor is generally concerned with contingencies arising from:
pending litigation for patent infringement, product liability or other actions,
income tax disputes
product warranties
notes receivable discounted
guarantees of obligations of others
unused balances of outstanding letters of credit

Terms: Types of contingencies

Diff: Easy

Objective: LO 24-2

AACSB: Reflective thinking skills

20) What are the three required conditions for a contingent liability to exist?

Answer:

1. There is potential for future payment to an outside party or the impairment of an asset that resulted from an existing condition
2. There is uncertainty about the amount of the future payment or impairment
3. The outcome will be resolved by some future event or events

Terms: Conditions for contingent liability to exist

Diff: Moderate

Objective: LO 24-2

AACSB: Reflective thinking skills

21) An environmental clean-up lawsuit is pending against your client. What information about the lawsuit would you as the auditor need in order to determine the proper accounting treatment?
Answer: The first step is to determine if a contingency exists. Three conditions are required for a contingent liability to exist: (1) there is a potential future payment to an outside party or the impairment of an asset that resulted from an existing condition; (2) there is uncertainty about the amount for the future payment or impairment; and (3) the outcome will be resolved by some future event or events.

Since the lawsuit meets the criteria for a contingent liability, the next step is to evaluate the significance of the potential liability and the nature of the disclosure needed in the financial statements to obtain evidence about the occurrence and right and obligations presentation and disclosure objective. Accounting standards describe three levels of likelihood of occurrence and the appropriate financial statement treatment for each likelihood as follows:

- a. Probable—future event likely to occur and amount can be reasonably estimated then the financial statement accounts are adjusted. If amount cannot be reasonably estimated, then a footnote disclosure is necessary.
- b. Reasonably possible—chance of occurring is more than remote, but less than probable. Footnote disclosure is necessary.
- c. Remote—chance of occurrence is slight. No disclosure is necessary.

Terms: Correct accounting for lawsuit

Diff: Moderate

Objective: LO 24-2

AACSB: Reflective thinking skills

22) Discuss three audit procedures commonly used to search for contingent liabilities.

Answer:

- Inquire of management (orally and in writing) about the possibility of unrecorded contingencies.
- Review current and previous years' internal revenue agent reports for income tax settlements.
- Review the minutes of directors' and stockholders' meetings for indications of lawsuits or other contingencies.
- Analyze legal expense for the period under audit, and review invoices and statements from legal counsel for indications of contingent liabilities.
- Obtain a letter from each major attorney performing legal services for the client as to the status of pending litigation or other contingent liabilities.
- Review audit documentation for any information that may indicate a potential contingency.
- Examine letters of credit in force as of the balance sheet date and obtain a confirmation of the used and unused balances.

Terms: Audit procedures for search of contingent liabilities

Diff: Moderate

Objective: LO 24-2

AACSB: Reflective thinking skills

23) A lawsuit has been filed against your client. If, in the opinion of legal counsel, the likelihood your client will lose the lawsuit is remote, no financial statement accrual or disclosure of the potential loss would generally be required.

A) True

B) False

Answer: A

Terms: Lawsuit is remote; financial statement accrual or disclosure

Diff: Easy

Objective: LO 24-2

AACSB: Reflective thinking skills

24) Current professional auditing standards make it clear that management, not the auditor, is responsible for identifying and deciding the appropriate accounting treatment for contingent liabilities.

A) True

B) False

Answer: A

Terms: Auditing standards; contingent liabilities

Diff: Moderate

Objective: LO 24-2

AACSB: Reflective thinking skills

25) Many of the audit procedures for finding contingencies are usually performed as an integral part of various segments of the audit rather than as a separate activity near the end of the audit.

A) True

B) False

Answer: A

Terms: Existence of contingent liabilities

Diff: Moderate

Objective: LO 24-2

AACSB: Reflective thinking skills

Learning Objective 24-3

1) Auditors will generally send a standard inquiry letter to:

A) only those attorneys who have devoted substantial time to client matters during the year.

B) every attorney that the client has been involved with in the current or preceding year, plus any attorney the client engages on occasion.

C) those attorneys whom the client relies on for advice related to substantial legal matters.

D) only the attorney who represents the client in proceeding where the client is defendant.

Answer: B

Terms: Standard inquiry letter

Diff: Easy

Objective: LO 24-3

AACSB: Reflective thinking skills

2) What needs to be included in a letter of inquiry sent to a client's legal counsel?

A)

Any pending threatened litigation with which the attorney has had significant involvement	The amount of legal fees paid by the client to the attorney
Yes	Yes

B)

Any pending threatened litigation with which the attorney has had significant involvement	The amount of legal fees paid by the client to the attorney
No	No

C)

Any pending threatened litigation with which the attorney has had significant involvement	The amount of legal fees paid by the client to the attorney
Yes	No

D)

Any pending threatened litigation with which the attorney has had significant involvement	The amount of legal fees paid by the client to the attorney
No	Yes

Answer: C

Terms: Letter of inquiry

Diff: Easy

Objective: LO 24-3

AACSB: Reflective thinking skills

3) Auditors, as part of completing the audit, will request the client to send a letter of inquiry to those attorneys the company has been consulting with during the year under audit regarding legal matters of concern to the company. The primary reason the auditor requests this information is to:

A) determine the range of probable loss for asserted claims.

B) corroborate of information supplied by management concerning litigation, claims, and assessments.

C) outside opinion of probability of losses in determining accruals for contingencies.

D) outside opinion of probability of losses in determining the proper footnote disclosure.

Answer: B

Terms: Completing the audit; Letter of inquiry

Diff: Moderate

Objective: LO 24-3

AACSB: Reflective thinking skills

4) The standard letter of inquiry to the client's legal counsel should be prepared on:

A) plain paper (no letterhead) and be unsigned.

B) lawyer's stationery and signed by the lawyer.

C) auditor's stationery and signed by an audit partner.

D) client's stationery and signed by a company official.

Answer: D

Terms: Letter of inquiry

Diff: Easy

Objective: LO 24-3

AACSB: Reflective thinking skills

5) What is one of the main reasons an attorney may refuse to provide auditors with complete information about contingent liabilities?

A)

The attorneys refuse to disclose information they consider confidential.	The attorneys refuse to respond due to a lack of knowledge about matters involving contingent liabilities.
Yes	Yes

B)

The attorneys refuse to disclose information they consider confidential.	The attorneys refuse to respond due to a lack of knowledge about matters involving contingent liabilities.
No	No

C)

The attorneys refuse to disclose information they consider confidential.	The attorneys refuse to respond due to a lack of knowledge about matters involving contingent liabilities.
Yes	No

D)

The attorneys refuse to disclose information they consider confidential.	The attorneys refuse to respond due to a lack of knowledge about matters involving contingent liabilities.
No	Yes

Answer: A

Terms: Letter of inquiry

Diff: Easy

Objective: LO 24-3

AACSB: Reflective thinking skills

6) An attorney is aware of a violation of a patent agreement that could result in a significant loss to the client if it were known. This is an example of a(n):

A) commitment.

B) unasserted claim.

C) pending litigation.

D) subsequent event.

Answer: B

Terms: Letter of inquiry

Diff: Moderate

Objective: LO 24-3

AACSB: Analytic skills

7) Management furnishes the independent auditor with information concerning litigation, claims, and assessments. Which of the following is the auditor's primary means of initiating action to corroborate such information?

- A) Request that client lawyers undertake a reconsideration of matters of litigation, claims, and assessments with which they were consulted during the period under examination.
- B) Request that client management send a letter of inquiry to those lawyers with whom management consulted concerning litigation, claims, and assessments.
- C) Request that client lawyers provide a legal opinion concerning the policies and procedures adopted by management to identify, evaluate, and account for litigation, claims, and assessments.
- D) Request that client management engage outside attorneys to suggest wording for the text of a footnote explaining the nature and probable outcome of existing litigation, claims, and assessments.

Answer: B

Terms: Corroborate information concerning litigation, claims, and assessments

Diff: Challenging

Objective: LO 24-3

AACSB: Reflective thinking skills

8) An attorney is responding to an independent auditor as a result of the client's letter of inquiry. The attorney may appropriately limit the response to:

- A) asserted claims and litigation.
- B) asserted, overtly threatened, or pending claims and litigation.
- C) items which have an extremely high probability of being resolved to the client's detriment.
- D) matters to which the attorney has given substantive attention in the form of legal consultation or representation.

Answer: D

Terms: Response to client's letter of inquiry

Diff: Challenging

Objective: LO 24-3

AACSB: Reflective thinking skills

9) Attorneys in recent years have become reluctant to provide certain information to auditors because of their own exposure to legal liability for providing incorrect or confidential information. State the two main reasons that attorneys refuse to provide the auditors with complete information.

Answer:

- The attorneys refuse to respond due to a lack of knowledge about matters involving contingent liabilities.
- The attorneys refuse to disclose information that they consider confidential.

Terms: Legal letter to client's attorneys

Diff: Easy

Objective: LO 24-3

AACSB: Reflective thinking skills

Topic: Public

10) State three items that should be included in a standard "inquiry of attorney" letter.

Answer:

- A list including (1) pending threatened litigation and (2) asserted or unasserted claims or assessments with which the attorney has had significant involvement. This list is typically prepared by management, but management may request that the attorney prepare the list.
- A request that the attorney furnish information or comment about the progress of each item listed, the legal action the client intends to take, the likelihood of an unfavorable outcome, and an estimate of the amount or range of the potential loss.
- A request for the identification of any unlisted pending or threatened legal actions or a statement that the client's list is complete.
- A statement by the client informing the attorney of his or her responsibility to inform management of legal matters requiring disclosure in the financial statements and to respond directly to the auditor.

Terms: Inquiry of attorney letter

Diff: Challenging

Objective: LO 24-3

AACSB: Reflective thinking skills

11) When preparing a standard inquiry of client's attorney letter, the client's letterhead should be used, and the letter should be signed by the client company's officials.

A) True

B) False

Answer: A

Terms: Standard inquiry of client's attorney letter

Diff: Moderate

Objective: LO 24-3

AACSB: Reflective thinking skills

12) In a standard inquiry of client's attorney letter, the attorney is requested to communicate about contingencies up to the balance sheet date.

A) True

B) False

Answer: B

Terms: Standard inquiry of client's attorney letter

Diff: Moderate

Objective: LO 24-3

AACSB: Reflective thinking skills

13) If an attorney refuses to provide the auditor with information about material existing lawsuits or unasserted claims, current professional standards require that the auditor consider the refusal as a scope limitation.

- A) True
- B) False

Answer: A

Terms: Attorney refuses to provide auditor with information about material existing lawsuits

Diff: Easy

Objective: LO 24-3

AACSB: Reflective thinking skills

Learning Objective 24-4

1) The auditor has a responsibility to review transactions and activities occurring after the balance sheet date to determine whether anything occurred that might affect the statements being audited. The procedures required to verify these transactions are commonly referred to as the review for:

- A) contingent liabilities.
- B) subsequent year's transactions.
- C) late unusual occurrences.
- D) subsequent events.

Answer: D

Terms: Review transactions and activities occurring after balance sheet date

Diff: Easy

Objective: LO 24-4

AACSB: Reflective thinking skills

2) Which type of subsequent event requires consideration by management and evaluation by the auditor?

A)

Subsequent events that have a direct effect on the financial statements and require adjustment.	Subsequent events that do not have a direct effect on the financial statements but for which disclosure may be required.
Yes	Yes

B)

Subsequent events that have a direct effect on the financial statements and require adjustment.	Subsequent events that do not have a direct effect on the financial statements but for which disclosure may be required.
No	No

C)

Subsequent events that have a direct effect on the financial statements and require adjustment.	Subsequent events that do not have a direct effect on the financial statements but for which disclosure may be required.
Yes	No

D)

Subsequent events that have a direct effect on the financial statements and require adjustment.	Subsequent events that do not have a direct effect on the financial statements but for which disclosure may be required.
No	Yes

Answer: A

Terms: Subsequent events requiring consideration by management

Diff: Easy

Objective: LO 24-4

AACSB: Reflective thinking skills

3) Whenever subsequent events are used to evaluate the amounts included in the statements, care must be taken to distinguish between conditions that existed at the balance sheet date and those that come into being after the balance sheet date. The subsequent information should not be incorporated directly into the statements if the conditions causing the change in valuation:

A) took place before the balance sheet date.

B) did not take place until after the balance sheet date.

C) occurred both before and after the balance sheet date.

D) are reimbursable through insurance policies.

Answer: B

Terms: Subsequent events; balance sheet date and after the end of the year

Diff: Easy

Objective: LO 24-4

AACSB: Reflective thinking skills

4) An auditor has the responsibility to actively search for subsequent events that occur subsequent to the:

- A) balance sheet date.
- B) date of the auditor's report.
- C) balance sheet date, but prior to the audit report.
- D) date of the management representation letter.

Answer: C

Terms: Subsequent events

Diff: Easy

Objective: LO 24-4

AACSB: Reflective thinking skills

5) Which of the following subsequent events is most likely to result in an adjustment to a company's financial statements?

- A) Merger or acquisition activities
- B) Bankruptcy (due to deteriorating financial condition) of a customer with an outstanding accounts receivable balance
- C) Issuance of common stock
- D) An uninsured loss of inventories due to a fire

Answer: B

Terms: Subsequent events; Adjustment to financial statements

Diff: Easy

Objective: LO 24-4

AACSB: Analytic skills

6) After the balance sheet date, but prior to the issuance of the audit report, the client suffers an uninsured loss of their inventory as a result of a fire. The amount of the loss is material. The auditor should:

- A) adjust the financial statements for the year under audit.
- B) add a paragraph to the audit report.
- C) advise the client to disclose the event in the notes to the financial statements.
- D) advise the client to delay issuing the financial statements until the economic loss can be determined.

Answer: C

Terms: Event will have a material effect on the financial statements

Diff: Easy

Objective: LO 24-4

AACSB: Analytic skills

7) The auditor has completed her assessment of subsequent events. The proper accounting for subsequent events that have a direct effect on the financial statements is to:

- A) adjust the financial statements for the year under audit.
- B) disclose in the notes to financial statement the amount of the adjustment.
- C) duly note in the audit workpapers that next year's financial statements need to be adjusted.
- D) make no adjustment of the financial statements for the year under audit.

Answer: A

Terms: Subsequent events; direct effect on the financial statements

Diff: Moderate

Objective: LO 24-4

AACSB: Reflective thinking skills

8) The audit procedures for the subsequent events review can be divided into two categories: (1) procedures integrated as a part of the verification of year-end account balances, and (2) those performed specifically for the purpose of discovering subsequent events. Which of the following procedures is in the first category?

- A) Inquire of client regarding contingent liabilities.
- B) Obtain a letter of representation written by client.
- C) Subsequent period sales and purchases transactions are examined to determine whether the cutoff is accurate.
- D) Review journals and ledgers of year 2 to determine the existence of any transactions related to year 1.

Answer: C

Terms: Audit procedures for subsequent events review

Diff: Moderate

Objective: LO 24-4

AACSB: Reflective thinking skills

9) The audit procedures for the subsequent events review can be divided into two categories: (1) procedures normally integrated as a part of the verification of year-end account balances, and (2) those performed specifically for the purpose of discovering subsequent events. Which of the following procedures is in the second category?

- A) Correspond with attorneys.
- B) Test the collectability of accounts receivable by reviewing subsequent period cash receipts.
- C) Subsequent period sales and purchases transactions are examined to determine whether the cutoff is accurate.
- D) Compare the subsequent-period purchase price of inventory with the recorded cost as a test of lower of cost or market valuation.

Answer: A

Terms: Audit procedures for subsequent events review

Diff: Moderate

Objective: LO 24-4

AACSB: Reflective thinking skills

10) Which of the following would be a subsequent discovery of facts which would **not** require a response by the auditor?

- A) Discovery of the inclusion of material nonexistent sales
- B) Discovery of the failure to write off material obsolete inventory
- C) Discovery of the omission of a material footnote
- D) Discovery of management's intent to increase selling prices in the future

Answer: D

Terms: Subsequent discovery of facts

Diff: Moderate

Objective: LO 24-4

AACSB: Reflective thinking skills

11) In connection with the annual audit, which of the following is **not** a "subsequent events" procedure?

- A) Prepare any necessary closing journal entries.
- B) Examine the minutes of stockholders and directors meetings subsequent to the balance sheet date.
- C) Review journals and ledgers.
- D) Obtain a letter of representation.

Answer: A

Terms: Subsequent events procedure

Diff: Moderate

Objective: LO 24-4

AACSB: Reflective thinking skills

12) An auditor performs interim work at various times throughout the year. The auditor's subsequent events work should be extended to the date of:

- A) the auditor's report.
- B) a post-dated footnote.
- C) the next scheduled interim visit.
- D) the final billing for audit services rendered.

Answer: A

Terms: Interim work; Subsequent events

Diff: Moderate

Objective: LO 24-4

AACSB: Reflective thinking skills

13) Which event that occurred after the end of the fiscal year under audit but prior to issuance of the auditor's report would **not** require disclosure in the financial statements?

- A) Sale of a bond or capital stock issue
- B) Loss of plant or inventories as a result of fire or flood
- C) A significant decline in the market price of the corporation's stock
- D) A merger or acquisition

Answer: C

Terms: Event that occurred after the end of the fiscal year

Diff: Moderate

Objective: LO 24-4

AACSB: Analytic skills

14) Which of the following material events occurring subsequent to the balance sheet date would require an adjustment to the financial statements before they could be issued?

- A) Loss of a plant as a result of a flood
- B) Sale of long-term debt or capital stock
- C) Settlement of litigation in excess of the recorded liability
- D) Major purchase of a business that is expected to double the sales volume

Answer: C

Terms: Events occurring subsequent to the balance sheet date; Adjustment

Diff: Moderate

Objective: LO 24-4

AACSB: Analytic skills

15) If the auditor determines that a subsequent event that affects the current period financial statements occurred after fieldwork was completed but before the audit report was issued, what date(s) may the auditor use on the report?

A)

The date of the original last day of fieldwork only.	The date of the subsequent event only.	The date on which the last day of fieldwork occurred along with the date of the subsequent event.
Yes	Yes	No

B)

The date of the original last day of fieldwork only.	The date of the subsequent event only.	The date on which the last day of fieldwork occurred along with the date of the subsequent event.
No	Yes	Yes

C)

The date of the original last day of fieldwork only.	The date of the subsequent event only.	The date on which the last day of fieldwork occurred along with the date of the subsequent event.
No	Yes	No

D)

The date of the original last day of fieldwork only.	The date of the subsequent event only.	The date on which the last day of fieldwork occurred along with the date of the subsequent event.
No	No	Yes

Answer: B

Terms: Subsequent event; report date

Diff: Challenging

Objective: LO 24-4

AACSB: Analytic skills

16) An auditor's decision concerning whether or not to dual date an audit report is primarily based on the auditor's decision to:

A) extend appropriate audit procedures.

B) assume responsibility for events after the date of the auditor's report.

C) assume responsibility for event from fiscal year end to the date of the audit report.

D) roll the dice and hope for a successful outcome.

Answer: A

Terms: Dual date audit report

Diff: Challenging

Objective: LO 24-4

AACSB: Reflective thinking skills

17) The auditor's responsibility for "reviewing the subsequent events" of a public company that is about to issue new securities is normally limited to the period of time:

- A) beginning with the balance sheet date and ending with the date of the auditor's report.
- B) beginning with the start of the fiscal year under audit and ending with the balance sheet date.
- C) beginning with the start of the fiscal year under audit and ending with the date of the auditor's report.
- D) beginning with the balance sheet date and ending with the date the registration statement becomes effective.

Answer: D

Terms: Reviewing subsequent events; public company; issue new securities

Diff: Challenging

Objective: LO 24-4

AACSB: Reflective thinking skills

18) Subsequent events affecting the realization of assets ordinarily will require adjustments of the financial statements under examination because such events typically represent:

- A) the culmination of conditions that existed at the balance sheet date.
- B) additional new information related to events that were in existence on the balance sheet date.
- C) final estimates of losses relating to casualties occurring in the subsequent events period.
- D) preliminary estimate of losses relating to new events that occurred subsequent to the balance sheet date.

Answer: B

Terms: Subsequent events; realization of assets

Diff: Challenging

Objective: LO 24-4

AACSB: Reflective thinking skills

19) An auditor's decision concerning whether or not to "dual date" the audit report is based upon the auditor's willingness to:

- A) extend auditing procedures and assume responsibility for a greater period of time.
- B) accept responsibility for subsequent events.
- C) permit inclusion of a footnote captioned: event (unaudited) subsequent to the date of the auditor's report.
- D) assume responsibility for events subsequent to the issuance of the auditor's report.

Answer: A

Terms: Dual date audit report

Diff: Challenging

Objective: LO 24-4

AACSB: Reflective thinking skills

20) After an auditor has issued an audit report on a nonpublic entity, there is no obligation to make any further audit tests or inquiries with respect to the audited financial statements covered by that report **unless**:

- A) material adverse events occur after the date of the auditor's report.
- B) final determination or resolution was made of a contingency which had been disclosed in the financial statements.
- C) final determination or resolution was made on matters which had resulted in a qualification in the auditor's report.
- D) new information comes to the auditor's attention concerning an event that occurred prior to the date of the auditor's report that may have affected the auditor's report.

Answer: D

Terms: Issued audit report; further audit tests or inquiries

Diff: Challenging

Objective: LO 24-4

AACSB: Reflective thinking skills

21) A client has a calendar year-end. Listed below are four events that occurred after December 31. Which one of these subsequent events might result in adjustment of the December 31 financial statements?

- A) Sale of a major subsidiary
- B) Adoption of accelerated depreciation methods
- C) Write-off of a substantial portion of inventory as obsolete
- D) Collection of 90% of the accounts receivable existing at December 31

Answer: C

Terms: Subsequent events

Diff: Challenging

Objective: LO 24-4

AACSB: Analytic skills

22) The auditor's responsibility with respect to events occurring between the balance sheet date and the end of the audit examination is best expressed by which of the following statements?

- A) The auditor is fully responsible for events occurring in the subsequent period and should extend all detailed procedures through the last day of fieldwork.
- B) The auditor is responsible for determining that a proper cutoff has been made and performing a general review of events occurring in the subsequent period.
- C) The auditor's responsibility is to determine that a proper cutoff has been made and that transactions recorded on or before the balance sheet date actually occurred.
- D) The auditor has no responsibility for events occurring in the subsequent period unless these events affect transactions recorded on or before the balance sheet date.

Answer: B

Terms: Events occurring between balance sheet date and end of audit examination

Diff: Challenging

Objective: LO 24-4

AACSB: Reflective thinking skills

23) The fieldwork for the December 31, 2013 audit of Schmidt Corporation ended on March 17, 2014. The financial statements and auditor's report were issued on March 29, 2014. In each of the material situations (1 through 5) below, indicate the appropriate action (a, b, c). The possible actions are as follows:

- a. Adjust the December 31, 2013 financial statements.
- b. Disclose the information in a footnote in the December 31, 2013 financial statements.
- c. No action is required.

The situations are as follows:

_____ 1. On March 1, 2014, one of Schmidt Corporation's major customers declared bankruptcy. The customer's financial condition in 2013 was deteriorating and they owed Schmidt Corporation a large sum of money as of the balance sheet date.

_____ 2. On February 17, 2014, Schmidt Corporation sold some machinery for its book value.

_____ 3. On February 20, 2014, a flood destroyed the entire uninsured inventory in one of Schmidt's warehouses.

_____ 4. On January 5, 2014, there was a significant decline in the market value of the securities held for resale from their value as of the balance sheet date.

_____ 5. On March 10, 2014, the company settled a lawsuit at an amount significantly higher than the amount recorded as a liability on the books as of the balance sheet date.

Answer:

1. a
2. c
3. b
4. b
5. a

Terms: Actions for subsequent events

Diff: Challenging

Objective: LO 24-2 and LO 24-4

AACSB: Analytic skills

24) State the two primary types of subsequent events that require consideration by management and evaluation by the auditor, and give two examples of each type.

Answer:

- Type 1: Events that occur after the balance sheet date which provide additional information to management that helps them determine the fair presentation of account balances as of the balance sheet date. These events have a direct effect on the financial statements and require adjustment. Examples include declaration of bankruptcy by a customer with an outstanding accounts receivable balance due to deteriorating financial condition; settlement of litigation at an amount different from the amount recorded on the books; and the disposal of equipment not being used in operations at a price below the current book value.
- Type 2: Events that have no direct effect on the financial statements but for which disclosure is required. Subsequent events of this type are events that provide evidence about conditions which did not exist at the date of the balance sheet being reported on but arose after the balance sheet date and may be significant enough to require disclosure. Examples include a decline in the market value of securities held for temporary investment or resale; issuance of bonds or equity securities; a decline in the market value of inventory as a consequence of government action barring further sale of a product; the uninsured loss of inventories as a result of fire; and a merger or an acquisition.

Terms: Types of subsequent events

Diff: Moderate

Objective: LO 24-4

AACSB: Reflective thinking skills

25) The issuance of bonds by the client subsequent to the balance sheet date would require a footnote disclosure in, but no adjustment to, the financial statements under audit.

A) True

B) False

Answer: A

Terms: Issuance of bonds by client subsequent to year-end

Diff: Easy

Objective: LO 24-4

AACSB: Reflective thinking skills

26) Subsequent events which require adjustment to the financial statements provide additional information about significant conditions/events which did not exist at the balance sheet date.

A) True

B) False

Answer: B

Terms: Subsequent events

Diff: Moderate

Objective: LO 24-4

AACSB: Reflective thinking skills

27) When subsequent events are used to evaluate the amounts included in the year-end financial statements, auditors must distinguish between conditions that existed at the balance sheet date and those that came into being after the balance sheet date.

- A) True
- B) False

Answer: A

Terms: Subsequent events

Diff: Moderate

Objective: LO 24-4

AACSB: Reflective thinking skills

Learning Objective 24-5

1) The date of the management representation letter received from the client should coincide with which of the following?

- A) Date of latest subsequent event disclosed in the notes to the financial statements
- B) Date of the auditor's report
- C) Balance sheet date
- D) Engagement agreement

Answer: B

Terms: Management representation letter

Diff: Easy

Objective: LO 24-5

AACSB: Reflective thinking skills

2) Which of the following procedures and methods are important in assessing a company's ability to continue as a going concern?

A)

Discussions with management regarding potential financial difficulties.	Evaluation of management's plans to avoid bankruptcy.
Yes	Yes

B)

Discussions with management regarding potential financial difficulties.	Evaluation of management's plans to avoid bankruptcy.
No	No

C)

Discussions with management regarding potential financial difficulties.	Evaluation of management's plans to avoid bankruptcy.
Yes	No

D)

Discussions with management regarding potential financial difficulties.	Evaluation of management's plans to avoid bankruptcy.
No	Yes

Answer: A

Terms: Going concern

Diff: Moderate

Objective: LO 24-5

AACSB: Reflective thinking skills

3) The letter of representation obtained from an audit client should be:

A) dated as of the end of the period under audit.

B) dated as of the audit report date.

C) dated as of any date decided upon by the client and auditor.

D) dated as of the issuance of the financial statement.

Answer: B

Terms: Letter of representation

Diff: Easy

Objective: LO 24-5

AACSB: Reflective thinking skills

4) When should auditors generally assess a client's ability to continue as a going concern?

- A) Upon completion of the audit
- B) During the planning stages of the audit
- C) Throughout the entire audit process
- D) During testing and completion phases of the audit

Answer: C

Terms: Going concern

Diff: Moderate

Objective: LO 24-5

AACSB: Reflective thinking skills

5) Which of the following would the auditor expect to find in the client's management representation letter?

- A) Management's recommendations for internal control effectiveness improvements
- B) Management's plans for improving product quality
- C) Management's compliance with contractual arrangements that impact the financial statements
- D) Management's goals for improving earnings per share

Answer: C

Terms: Management representation letter

Diff: Moderate

Objective: LO 24-5

AACSB: Reflective thinking skills

6) Auditing standards require that the auditor evaluate whether there is a substantial doubt about a client's ability to continue as a going concern for at least:

- A) one quarter beyond the balance sheet date.
- B) one quarter beyond the date of the auditor's report.
- C) one year beyond the balance sheet date.
- D) one year beyond the date of the auditor's report.

Answer: C

Terms: Auditing standards; Going-concern issues

Diff: Moderate

Objective: LO 24-5

AACSB: Reflective thinking skills

7) Auditing standards require auditors to evaluate whether there is a substantial doubt about a client's ability to continue as a going concern. One of the most important audit procedures to perform to assess the going concern question is:

- A) analytical procedures.
- B) confirmations from creditors.
- C) statistical sampling procedures.
- D) inquiries of client and its legal counsel.

Answer: A

Terms: Audit procedures to assess going concern

Diff: Moderate

Objective: LO 24-5

AACSB: Reflective thinking skills

- 8) Which of the following statements regarding the letter of representation is **not** correct?
- A) It is prepared on the client's letterhead.
 - B) It is addressed to the CPA firm.
 - C) It is signed by high-level corporate officials, usually the president and chief financial officer.
 - D) It is optional, not required, that the auditor obtain such a letter from management.

Answer: D

Terms: Letter of representation

Diff: Moderate

Objective: LO 24-5

AACSB: Reflective thinking skills

- 9) Refusal by a client to prepare and sign the representation letter would require the auditor to issue a:

- A) qualified opinion or a disclaimer of opinion.
- B) adverse opinion or a disclaimer of opinion.
- C) qualified or an adverse opinion.
- D) unqualified opinion with an explanatory paragraph.

Answer: A

Terms: Refusal to prepare and sign the letter of representation

Diff: Easy

Objective: LO 24-5

AACSB: Reflective thinking skills

- 10) A client representation letter is:

- A) prepared on the CPA's letterhead.
- B) addressed to the client.
- C) signed by high-level corporate officials.
- D) dated as of the balance sheet date.

Answer: C

Terms: Client representation letter

Diff: Easy

Objective: LO 24-5

AACSB: Reflective thinking skills

- 11) Which of the following is correct regarding supplementary information?

- A) The auditor must express an opinion on the supplementary information.
- B) When reporting on supplementary information, the auditor uses a different materiality threshold from that used in forming an opinion on the basic financial statements.
- C) If the auditor's report on the audited financial statements contains an adverse opinion, the auditor can still issue an unqualified opinion on the supplementary information.
- D) The auditor can issue a separate report on the supplementary information; it does not need to be part of the report on the financial statements.

Answer: D

Terms: Supplementary information accompanying basic financial statements

Diff: Moderate

Objective: LO 24-5

AACSB: Reflective thinking skills

12) Which of the following is **not** one of the categories of items included in the client letter of representation?

- A) Subsequent events
- B) Completeness of information
- C) Recognition, measurement, and disclosure
- D) Materiality

Answer: D

Terms: Client letter of representation

Diff: Easy

Objective: LO 24-5

AACSB: Reflective thinking skills

13) Which of the following audit procedures would most likely assist an auditor in identifying conditions and events that may indicate there could be substantial doubt about an entity's ability to continue as a going concern?

- A) Review compliance with the terms of debt agreements
- B) Confirmation of accounts receivable from principal customers
- C) Reconciliation of interest expense with debt outstanding
- D) Confirmation of bank balances

Answer: A

Terms: Audit procedures; entity's ability to continue as a going concern

Diff: Moderate

Objective: LO 24-5

AACSB: Reflective thinking skills

14) Which of the following statements is correct?

- A) A letter of representation is documentation of management's acceptance of responsibility for the financial statements and is deemed to be reliable evidence.
- B) A letter of representation is not deemed to be reliable evidence because of the potential incompetence of management.
- C) A letter of representation is not deemed to be reliable evidence because of the lack of independence of the preparers.
- D) A letter of representation is documentation of the CPA's acceptance of responsibility for the audit of the financial statement and is deemed to be reliable.

Answer: C

Terms: Letter of representation

Diff: Moderate

Objective: LO 24-5

AACSB: Reflective thinking skills

15) Auditing standards require the auditor to _____ other information included in annual reports pertaining directly to the financial statements.

- A) audit
- B) express an opinion on
- C) read
- D) analyze

Answer: C

Terms: Other information included in annual reports

Diff: Moderate

Objective: LO 24-5

AACSB: Reflective thinking skills

16) An auditor must obtain written client representations that might be signed by all but which of the following?

- A) Treasurer
- B) Chief financial officer
- C) Vice president of operations
- D) Chief executive officer

Answer: C

Terms: Client representations signed by

Diff: Easy

Objective: LO 24-5

AACSB: Reflective thinking skills

17) Which of the following is **not** a reason why the auditor requests that the client provide a letter of representation?

- A) Professional auditing standards require the auditor to obtain a letter of representation.
- B) It impresses upon management its responsibility for the accuracy of the information in the financial statements.
- C) It provides written documentation of the oral responses already received to inquiries of management.
- D) It determines the type of opinion the auditor will issue on the financial statements.

Answer: D

Terms: Letter of representation

Diff: Challenging

Objective: LO 24-5

AACSB: Reflective thinking skills

18) At the completion of the audit, management is asked to make a written statement that it is not aware of any undisclosed contingent liabilities. This statement would appear in the:

- A) management letter.
- B) letter of inquiry.
- C) letters testamentary.
- D) management letter of representation.

Answer: D

Terms: Completion of audit; written statement by management

Diff: Easy

Objective: LO 24-5

AACSB: Reflective thinking skills

19) What two steps must an auditor do if they have reservations about the audit client continuing as a going concern?

- Answer: 1. Evaluate management's plan to avoid bankruptcy
2. Feasibility of management achieving those plans

Terms: Going concern

Diff: Easy

Objective: LO 24-5

AACSB: Reflective thinking skills

20) State the three purposes of the client letter of representation.

Answer:

- To impress upon management its responsibility for the assertions in the financial statements.
- To remind management of potential misstatements or omissions in the financial statements.
- To document the responses from management to inquiries about various aspects of the audit.

Terms: Client representation letter

Diff: Moderate

Objective: LO 24-5

AACSB: Reflective thinking skills

21) List four specific matters that should be included in a client representation letter.

Answer:

- Management's acknowledgment of its responsibility for the fair presentation of the financial statements
- Management's belief that the financial statements are fairly presented in conformity with applicable accounting standards.
- Availability of all financial records and related data
- Completeness and availability of all minutes of meetings of stockholders, directors, and committees of directors
- Absence of unrecorded transactions
- Management's belief that the effects of any uncorrected financial statement misstatements are immaterial to the financial statements
- Information concerning fraud involving (a) management, (b) employees who have significant roles in internal control, or (c) others where fraud could have a material effect on the financial statements
- An acknowledgment by management of its responsibility to design and implement internal control to prevent and detect fraud
- Information concerning related-party transactions and amounts receivable or payable to related parties
- Unasserted claims or assessments that the entity's lawyer has advised are probable of assertion and must be disclosed in accordance with accounting standards
- Bankruptcy of a major customer with an outstanding account receivable at the balance sheet date.
- A merger or acquisition after the balance sheet date.

Terms: Client representation letter

Diff: Moderate

Objective: LO 24-5

AACSB: Reflective thinking skills

22) Besides the search for contingent liabilities and the review for subsequent events, the auditor has four important final evidence accumulation responsibilities, all of which are required by current professional auditing standards. Discuss each of these four responsibilities.

Answer:

- Final analytical procedures performed as a final review for material misstatements or financial problems and to help the auditor take a final objective look at the financial statements.
- Evaluate the going concern assumption.
- Obtain a management representation letter documenting management's most important oral representations during the audit.
- Consider supplementary information included in published annual reports pertaining directly to the financial statements.

Terms: Final evidence accumulation responsibilities required by professional auditing standards

Diff: Challenging

Objective: LO 24-5

AACSB: Reflective thinking skills

23) Current professional auditing standards require the performance of analytical procedures during the planning and completion phases of the audit.

A) True

B) False

Answer: A

Terms: Analytical procedures; Planning and completion phases of the audit

Diff: Easy

Objective: LO 24-5

AACSB: Reflective thinking skills

24) Current professional auditing standards mandate the use of analytical procedures during the testing phase of the audit.

A) True

B) False

Answer: B

Terms: Professional auditing standards; Analytical procedures; Testing phase of audit

Diff: Easy

Objective: LO 24-5

AACSB: Reflective thinking skills

25) Auditing standards require the auditor's assessment of going-concern issues.

A) True

B) False

Answer: A

Terms: Auditing standards; Going-concern issues

Diff: Moderate

Objective: LO 24-5

AACSB: Reflective thinking skills

26) Results from the final analytical procedures may indicate that additional audit evidence is necessary.

A) True

B) False

Answer: A

Terms: Analytical procedures in stages of audit

Diff: Moderate

Objective: LO 24-5

AACSB: Reflective thinking skills

27) Although the letter of representation is typed on the client's letterhead and signed by the client, it is common for the auditor to prepare the letter.

A) True

B) False

Answer: A

Terms: Letter of representation

Diff: Moderate

Objective: LO 24-5

AACSB: Reflective thinking skills

28) Auditors of public companies must obtain certain representations from management regarding internal control over financial reporting.

A) True

B) False

Answer: A

Terms: Representations from management regarding internal control

Diff: Moderate

Objective: LO 24-5

AACSB: Reflective thinking skills

Topic: Public

29) At the completion of the audit, management is typically asked to make a written statement as a part of the engagement letter that it is aware of no undisclosed contingent liabilities.

A) True

B) False

Answer: B

Terms: Completion of audit; written statement by management; undisclosed liabilities

Diff: Moderate

Objective: LO 24-5

AACSB: Reflective thinking skills

30) Auditors are required to obtain a letter of representation that describes management's planned solutions to all internal control weaknesses identified during an audit.

A) True

B) False

Answer: B

Terms: Letter of representation

Diff: Moderate

Objective: LO 24-5

AACSB: Reflective thinking skills

31) The letter of representation is prepared on the CPA firm's letterhead, addressed to the client's chief executive officer, and signed by the audit engagement partner.

A) True

B) False

Answer: B

Terms: Letter of representation

Diff: Moderate

Objective: LO 24-5

AACSB: Reflective thinking skills

32) If the client refuses to prepare and sign a letter of representation, the auditor would be required to issue either a qualified opinion or a disclaimer of opinion.

A) True

B) False

Answer: A

Terms: Letter of representation; issue opinion

Diff: Moderate

Objective: LO 24-5

AACSB: Reflective thinking skills

33) Because a management representation letter is a written statement from a nonindependent source, it cannot be regarded as reliable evidence.

A) True

B) False

Answer: A

Terms: Client representation letter; reliable evidence

Diff: Moderate

Objective: LO 24-5

AACSB: Reflective thinking skills

Learning Objective 24-6

1) To make a final evaluation as to whether sufficient appropriate evidence has been accumulated, the auditor will do all of the following **except**:

A) review the audit documentation for the entire audit to determine whether all material classes of transactions have been adequately tested.

B) make sure that all parts of the audit program have been accurately completed and documented.

C) obtain the management representation letter.

D) decide whether the audit program is adequate.

Answer: C

Terms: Sufficient evidence to draw a conclusion

Diff: Easy

Objective: LO 24-6

AACSB: Reflective thinking skills

2) When reviewing the summary of misstatements found in the audit:

A) an adjusting journal entry must be made by the auditor for all material misstatements.

B) auditors must combine individually immaterial misstatements to evaluate whether the combined amount is material.

C) the auditor is not required to consider the impact on the current financial statements of misstatements in the prior year that were not corrected.

D) auditors only need to consider the misstatements that impact the income statement.

Answer: B

Terms: Sufficient evidence to draw a conclusion

Diff: Easy

Objective: LO 24-6

AACSB: Reflective thinking skills

3) Match seven of the terms (a-p) with the description/definitions provided below (1-7):

- a. Commitments
- b. Completing the engagement checklist
- c. Contingent liability
- d. Dual-dated audit report
- e. Financial statement disclosure checklist
- f. Independent review
- g. Inquiry of client's attorneys
- h. Letter of representation
- i. Other information in annual reports
- j. Review for subsequent events
- k. Subsequent events
- l. Unadjusted misstatement worksheet
- m. Management letter
- n. Pending claim
- o. Unasserted claim
- p. Audit documentation review

_____ 1. A review of the financial statements and the entire set of audit files by an independent reviewer to whom the audit team must justify the evidence accumulated and the conclusions reached.

_____ 2. A potential future obligation to an outside party for an unknown amount resulting from activities that have already taken place.

_____ 3. A written communication from the client to the auditor formalizing statements that the client has made about matters pertinent to the audit.

_____ 4. A potential legal claim against a client where the condition for a claim exists but no claim has been filed.

_____ 5. Transactions that occurred after the balance sheet date, which affect the fair presentation or disclosure of the statements being audited.

_____ 6. Agreements that the entity will hold to a fixed set of conditions, such as the purchase or sale of merchandise at a stated price.

_____ 7. The use of one audit report date for normal subsequent events and a later date for one or more subsequent events.

Answer:

1. f
2. c
3. h
4. o
5. k
6. a
7. d

Terms: Independent review; Contingent liability; Letter of representation; Unasserted claim; Subsequent events; Commitments; Dual-dated audit report

Diff: Moderate

Objective: LO 24-2 through LO 24-6

AACSB: Reflective thinking skills

4) List the three reasons why an experienced member of the audit firm must thoroughly review audit documentation at the completion of the audit.

Answer:

1. To evaluate the performance of inexperienced personnel
2. To make sure that the audit meets the CPA firm's standard of performance
3. To counteract the bias that often enters into the auditor's judgment.

Terms: Audit documentation for audit

Diff: Moderate

Objective: LO 24-6

AACSB: Reflective thinking skills

5) An independent review must be performed of all audits.

- A) True
- B) False

Answer: B

Terms: Independent review

Diff: Easy

Objective: LO 24-6

AACSB: Reflective thinking skills

6) If, during the completion phase of the audit, the auditor determines that he or she has not obtained sufficient evidence to draw a conclusion about the fairness of the client's financial statements, there are two choices: accumulate additional evidence or issue either a qualified or an adverse opinion.

- A) True
- B) False

Answer: B

Terms: Sufficient evidence to draw a conclusion

Diff: Moderate

Objective: LO 24-6

AACSB: Reflective thinking skills

7) After performing all audit procedures in each area, the auditor must integrate the results into an overall conclusion about the financial statements.

A) True

B) False

Answer: A

Terms: Sufficient evidence to draw a conclusion

Diff: Moderate

Objective: LO 24-6

AACSB: Reflective thinking skills

Learning Objective 24-7

1) The auditor is responsible for communicating significant internal control deficiencies to the audit committee, or those charged with governance. This communication:

A) may be oral or written.

B) must be oral.

C) must be written.

D) must be oral via direct communication.

Answer: C

Terms: Communicate significant internal control deficiencies

Diff: Easy

Objective: LO 24-7

AACSB: Reflective thinking skills

2) Which of the following statements is most correct about an auditor's required communication with management and those charged with corporate governance?

A) The auditor is required to inform those charged with governance about significant errors discovered and subsequently corrected by management.

B) Any significant matter reported to those charged with governance must also be communicated to management.

C) Communication is required before the audit report is issued.

D) Auditor does not have any requirement to communicate with anyone other than the company's senior management.

Answer: A

Terms: Required communication with management; corporate governance

Diff: Moderate

Objective: LO 24-7

AACSB: Reflective thinking skills

- 3) While there is no professional requirement to do so on audit engagements, CPAs frequently issue a formal "management" letter to clients. The primary purpose of this letter is to provide:
- A) evidence indicating whether the auditor is reasonably certain that internal accounting control is operating as prescribed.
 - B) a permanent record of the internal accounting control work performed by the auditor during the course of the engagement.
 - C) a written record of discussions between auditor and client concerning the auditor's observations and suggestions for improvements.
 - D) a summary of the auditor's observations that resulted from the auditor's special study of internal control.

Answer: C

Terms: Management letter purpose

Diff: Moderate

Objective: LO 24-7

AACSB: Reflective thinking skills

- 4) When communicating with the audit committee and management:
- A) only material fraud and illegal acts are required by auditing standards to be communicated.
 - B) all internal control deficiencies are required by auditing standards to be communicated.
 - C) the communications should be made in a timely manner to allow those charged with governance to take appropriate actions.
 - D) all communications with the audit committee and management must be in writing.

Answer: C

Terms: Communicated to the audit committee or designate body

Diff: Moderate

Objective: LO 24-7

AACSB: Reflective thinking skills

- 5) Auditing standards require the auditor to communicate all management frauds and illegal acts to the audit committee:
- A) only if the act is immaterial.
 - B) only if the act is material.
 - C) only if the act is highly material.
 - D) regardless of materiality.

Answer: D

Terms: Auditing standards; Frauds and illegal acts; Audit committee

Diff: Easy

Objective: LO 24-7

AACSB: Reflective thinking skills

6) Discuss the four principal purposes of the required communication with the audit committee regarding certain additional information obtained during the audit.

Answer:

- To communicate auditor responsibilities in the audit of financial statements.
- To provide an overview of the scope and timing of the audit.
- To provide those charged with governance with significant findings arising during the audit.
- To obtain from those charged with governance information relevant to the audit.

Terms: Other communications with audit committee

Diff: Moderate

Objective: LO 24-7

AACSB: Reflective thinking skills

Topic: SOX

7) Auditors are required to communicate either orally or in writing with the audit committee about internal control weaknesses.

A) True

B) False

Answer: B

Terms: Auditors required to communicate with audit committee; Internal control weaknesses

Diff: Moderate

Objective: LO 24-7

AACSB: Reflective thinking skills

8) Auditors must communicate in writing about internal control weaknesses to the audit committee or those charged with governance.

A) True

B) False

Answer: A

Terms: Auditors communicate internal control weaknesses

Diff: Moderate

Objective: LO 24-7

AACSB: Reflective thinking skills

9) Client representation letters are required by professional auditing standards, whereas management letters are optional.

A) True

B) False

Answer: A

Terms: Client representation letters; Management letters; Auditing standards

Diff: Moderate

Objective: LO 24-5 and LO 24-7

AACSB: Reflective thinking skills

Learning Objective 24-8

1) The audit firm issues an audit report for its client. The auditor's have NO obligation to make further inquiries with respect to the client's audited financial statements unless:

A) a development occurs that may affect the company's long term viability as a company.

B) final resolution was made on disclosed contingency for which no liability needed to be accrued.

C) new information comes to the auditor's attention concerning an event that occurred prior to the date of the audit report that, if known, would have impacted the audit opinion.

D) a lawsuit, in which the risk of loss was considered remote, was resolved in the company's favor.

Answer: C

Terms: Audit report; Further inquiries

Diff: Moderate

Objective: LO 24-8

AACSB: Analytic skills

2) The fieldwork for the December 31, 2013 audit of Treble Corporation ended on March 17, 2014. The financial statements and auditor's report were issued and mailed to stockholders on March 29, 2014. In each of the material situations (1 through 5) below, indicate the appropriate action (a, b, c, d, or e). The possible actions are as follows:

- a. Adjust the December 31, 2013 financial statements.
- b. Disclose the information in a footnote in the December 31, 2013 financial statements.
- c. Request the client revise and reissue the December 31, 2013 financial statements. The revision should involve an adjustment to the December 31, 2013 financial statements.
- d. Request the client revise and reissue the December 31, 2013 financial statements. The revision should involve the addition of a footnote, but no adjustment, to the December 31, 2013 financial statements.
- e. No action is required.

The situations are as follows:

_____ 1. On January 16, 2014 a lawsuit was filed against Treble for a patent infringement action that allegedly took place in early 2010. In the opinion of Treble's attorneys, there is a reasonable (but not probable) danger of a significant loss to Treble.

_____ 2. On February 19, 2014, Treble settled a lawsuit out of court that had originated in 2009 and is currently listed as a contingent liability.

_____ 3. On March 30, 2014, Treble settled a lawsuit out of court that had originated in 2007 and is currently listed as a contingent liability.

_____ 4. On February 2, 2014, you discovered an uninsured lawsuit against Treble that had originated on August 30, 2010.

_____ 5. On April 7, 2014, you discovered that a debtor of Treble went bankrupt on January 22, 2014, due to a major uninsured fire that occurred on January 2, 2014.

Answer:

1. b
2. a
3. e
4. b
5. d

Terms: Actions for subsequent events

Diff: Challenging

Objective: LO 24-2, LO 24-6, and LO 24-8

AACSB: Analytic skills

3) If an auditor discovers that previously issued financial statements are misleading, the most desirable approach to follow is to request that the client issue an immediate revision of the financial statements containing an explanation of the reasons for the revision.

A) True

B) False

Answer: A

Terms: Auditor discovers that previously issued financial statements are misleading

Diff: Easy

Objective: LO 24-8

AACSB: Reflective thinking skills

4) Subsequent discoveries of facts requiring the reissuance of financial statements arise from events occurring after the date of the auditor's report.

A) True

B) False

Answer: B

Terms: Events that occur after the date of the auditor's report

Diff: Moderate

Objective: LO 24-8

AACSB: Reflective thinking skills