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## **Uniform CPA Examination/May 1980-November 1984, Auditing: Selected Questions and Unofficial Answers Indexed to Content Specification Outline**

James D. Blum

Edward R. Gehl

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Uniform CPA Examination/May 1980 — November 1984

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Selected Questions  
And Unofficial Answers  
Indexed To  
Content Specification  
Outline

edited by James D. Blum and Edward R. Gehl

**AICPA**

American Institute of Certified Public Accountants

auditing

AICPA

# auditing

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## Selected Questions And Unofficial Answers Indexed To Content Specification Outline

edited by  
James D. Blum  
Assistant Director, Examinations Division  
Edward R. Gehl  
Technical Manager, Examinations Division

**AICPA**  
American Institute of Certified Public Accountants



## FOREWORD

The Uniform CPA Examination is prepared by the Board of Examiners of the American Institute of Certified Public Accountants, and is used by the examining boards of all fifty states of the United States, the District of Columbia, Puerto Rico, Guam, and the Virgin Islands, as a prerequisite for issuance of CPA certificates.

This booklet contains selected questions and unofficial answers from the last ten Auditing sections of the Uniform Certified Public Accountant Examination. The questions and unofficial answers have been indexed in accordance with the Auditing Content Specification Outline for the Uniform Certified Public Accountant Examination.

All questions are identified by a boldface code indicating the month—May (**M**) or November (**N**)—the year (**80** through **84**), and the question number in the original examination. Within the content specification areas and groups, questions and answers have been arranged in reverse chronological order.

Each individual multiple choice question is indexed according to the area and group it tests. In some cases, a common fact pattern is used for two or more multiple choice questions. In such cases, where different areas and groups are being tested by questions referring to a common fact pattern, the fact pattern is repeated to accompany the questions indexed in each applicable area or group.

Where essay questions and their answers involve more than one part—for example, part a. and part b.—the essays have been separated and indexed according to areas and groups tested. Thus, all parts of a question and its answer may not appear in their original examination sequence.

Although the questions and unofficial answers may be used for many purposes, the principal reason for their publication is to aid candidates in preparing to take the examination. Candidates are also encouraged to read *Information for CPA Candidates*, which describes the content, grading, and other administrative aspects of the Uniform CPA Examination.

The unofficial answers were prepared by the staff of the Examinations Division and reviewed by the Board of Examiners but are not purported to be official positions of the American Institute of Certified Public Accountants.

William C. Bruschi, *Vice President—Regulation*  
American Institute of Certified Public Accountants

January 1985



## TABLE OF CONTENTS

	Pages	
	Multiple Choice Items	Essays
<b>Selected Questions</b>		
I. Professional Responsibilities	1	63†
A. General Standards and Rules of Conduct	1	
B. Control of the Audit	5	
C. Other Responsibilities	7	
II. Internal Control	12	63
A. Definitions and Basic Concepts	12	63
B. Study and Evaluation of the System	14	64
C. Cycles	17	65
D. Other Considerations	20	72
III. Audit Evidence and Procedures	27	73
A. Audit Evidence	27	73
B. Specific Audit Objectives and Procedures	37	76
C. Other Specific Topics	41	79
IV. Reporting	45	79
A. Reporting Standards and Types of Reports	45	79
B. Other Reporting Considerations	55	*
<b>Selected Multiple Choice Items — Unofficial Answers</b>	59	
<b>Essays — Selected Questions</b>	63	
<b>Selected Essays — Unofficial Answers</b>	83	
<b>Suggested References</b>	99	
<b>Appendix — Content Specification Outline</b>	101	

\* No essays were indexed for this group.

† Questions in this area are not classified according to group.





## MULTIPLE CHOICE ITEMS — SELECTED QUESTIONS

### I. Professional Responsibilities

#### A. General Standards and Rules of Conduct

- N84#1.** A CPA, while performing an audit, strives to achieve independence in appearance in order to
- Reduce risk and liability.
  - Comply with the generally accepted standards of field work.
  - Become independent in fact.
  - Maintain public confidence in the profession.
- N84#2.** The AICPA Code of Professional Ethics states that a CPA shall not disclose any confidential information obtained in the course of a professional engagement except with the consent of the client. This rule should be understood to preclude a CPA from responding to an inquiry made by
- An investigative body of a state CPA society.
  - The trial board of the AICPA.
  - A CPA-shareholder of the client corporation.
  - An AICPA voluntary quality review body.
- N84#37.** Pursuant to the AICPA rules of conduct, if a partner in a two-member partnership dies, the surviving partner may continue to practice as an individual under the existing firm title which includes the deceased partner's name
- For a period of time **not** to exceed five years.
  - For a period of time **not** to exceed two years.
  - Indefinitely.
  - Until the partnership pay-out to the deceased partner's estate is terminated.
- N84#46.** Inclusion of which of the following in a promotional brochure published by a CPA firm would be most likely to result in a violation of the AICPA rules of conduct?
- Reprints of newspaper articles which are laudatory with respect to the firm's expertise.
  - Services offered and fees for such services, including hourly rates and fixed fees.
  - Educational and professional attainments of partners.
  - Testimonials and endorsements.
- N84#59.** According to the AICPA Code of Professional Ethics, a CPA who has a financial interest in a partnership that invests in a potential client is considered to have
- An indirect financial interest in the client.
  - A direct financial interest in the client.
  - No financial interest in the client.
  - A partial financial interest in the client.
- M84#1.** Adequate technical training and proficiency as an auditor encompasses an ability to understand an EDP system sufficiently to identify and evaluate
- The processing and imparting of information.
  - Essential accounting control features.
  - All accounting control features.
  - The degree to which programming conforms with application of generally accepted accounting principles.
- M84#51.** Which of the following underlies the application of generally accepted auditing standards, particularly the standards of field work and reporting?
- The elements of materiality and relative risk.
  - The element of internal control.
  - The element of corroborating evidence.
  - The element of quality control.
- M84#54.** Which of the following is responsible for the fairness of the representations made in financial statements?
- Client's management
  - Independent auditor
  - Audit committee
  - AICPA
- N83#8.** The application of statistical sampling techniques is **least** related to which of the following generally accepted auditing standards?
- The work is to be adequately planned and assistants, if any, are to be properly supervised.
  - In all matters relating to the assignment, an independence in mental attitude is to be maintained by the auditor or auditors.

## Auditing

- c. There is to be a proper study and evaluation of the existing internal control as a basis for reliance thereon and for the determination of the resultant extent of the tests to which auditing procedures are to be restricted.
- d. Sufficient competent evidential matter is to be obtained through inspection, observation, inquiries and confirmations to afford a reasonable basis for an opinion regarding the financial statements under examination.

**N83#19.** Competence as a certified public accountant includes all of the following **except**

- a. Having the technical qualifications to perform an engagement.
- b. Possessing the ability to supervise and evaluate the quality of staff work.
- c. Warranting the infallibility of the work performed.
- d. Consulting others if additional technical information is needed.

**N83#36.** Which of the following ultimately determines the specific audit procedures necessary to provide an independent auditor with a reasonable basis for the expression of an opinion?

- a. The audit program.
- b. The auditor's judgment.
- c. Generally accepted auditing standards.
- d. The auditor's working papers.

**N83#46.** The AICPA Rules of Conduct will ordinarily be considered to have been violated when the CPA represents that specific consulting services will be performed for a stated fee and it is apparent at the time of the representation that the

- a. Actual fee would be substantially higher.
- b. Actual fee would be substantially lower than the fees charged by other CPAs for comparable services.
- c. Fee was a competitive bid.
- d. CPA would **not** be independent.

**N83#55.** An auditor is about to commence a recurring annual audit engagement. The continuing auditor's independence would ordinarily be considered to be impaired if the prior year's audit fee

- a. Was only partially paid and the balance is being disputed.
- b. Has **not** been paid and will **not** be paid for at least twelve months.
- c. Has **not** been paid and the client has filed a voluntary petition for bankruptcy.
- d. Was settled by litigation.

**N83#56.** A CPA's license to practice will ordinarily be suspended or revoked automatically for

- a. Committing an act discreditable to the profession.
- b. Conviction of willful failure to file personal income tax returns.
- c. Refusing to respond to an inquiry by the AICPA practice review committee.
- d. Accepting compensation while honoring a subpoena to appear as an expert witness.

**N82#47.** In determining independence with respect to any audit engagement, the ultimate decision as to whether or **not** the auditor is independent must be made by the

- a. Auditor.
- b. Client.
- c. Audit committee.
- d. Public.

**N82#48.** A CPA certificate is evidence of

- a. Recognition of independence.
- b. Basic competence at the time the certificate is granted.
- c. Culmination of the educational process.
- d. Membership in the AICPA.

**N82#49.** An individual just entering upon an auditing career must obtain professional experience primarily in order to achieve a

- a. Positive quality control review.
- b. Seasoned judgment.
- c. Favorable peer review.
- d. Specialty designation by the AICPA.

**M82#20.** In which of the following instances would the independence of the CPA **not** be considered to be impaired? The CPA has been retained as the auditor of a brokerage firm

- a. Which owes the CPA audit fees for more than one year.
- b. In which the CPA has a large active margin account.
- c. In which the CPA's brother is the controller.
- d. Which owes the CPA audit fees for current-year services and has just filed a petition for bankruptcy.

**M82#23.** Pursuant to the AICPA rules of conduct, the auditor's responsibility to the profession is defined by

- a. The AICPA Code of Professional Ethics.
- b. Federal laws governing licensed professionals who are involved in interstate commerce.
- c. Statements on Auditing Standards.
- d. The Bylaws of the AICPA.

**M82#25.** A CPA who is seeking to sell an accounting practice must

*Selected Questions*

- a. Not allow a peer review team to look at working papers and tax returns without permission from the client prior to consummation of the sale.
- b. Not allow a prospective purchaser to look at working papers and tax returns without permission from the client.
- c. Give all working papers and tax returns to the client.
- d. Retain all working papers and tax returns for a period of time sufficient to satisfy the statute of limitations.

**M82#33.** Mavis, CPA, has audited the financial statements of South Bay Sales Incorporated for several years and had always been paid promptly for services rendered. Last year's audit invoices have not been paid because South Bay is experiencing cash flow difficulties, and the current year's audit is scheduled to commence in one week. With respect to the past due audit fees Mavis should

- a. Perform the scheduled audit and allow South Bay to pay when the cash flow difficulties are alleviated.
- b. Perform the scheduled audit only after arranging a definite payment schedule and securing notes signed by South Bay.
- c. Inform South Bay's management that the past due audit fees are considered an impairment of auditor independence.
- d. Inform South Bay's management that the past due audit fees may be considered a loan on which interest must be imputed for financial statement purposes.

**M82#43.** In performing an audit, Jackson, CPA, discovers that the professional competence necessary for the engagement is lacking. Jackson informs management of the situation and recommends another local CPA firm, and management engages this other firm. Under these circumstances

- a. Jackson may request compensation from the other CPA firm for any professional services rendered to it in connection with the engagement.
- b. Jackson may accept a referral fee from the other CPA firm.
- c. Jackson has violated the AICPA Code of Professional Ethics because of nonfulfillment of the duty of performance.
- d. Jackson's lack of competence should be construed to be a violation of generally accepted auditing standards.

**M82#48.** In which of the following instances would the independence of the CPA **not** be considered to be impaired? The CPA has been retained as the auditor of a

- a. Charitable organization in which an employee of the CPA serves as treasurer.
- b. Municipality in which the CPA owns \$25,000 of the \$2,500,000 indebtedness of the municipality.
- c. Cooperative apartment house in which the CPA owns an apartment and is **not** part of the management.
- d. Company in which the CPA's investment club owns a one-tenth interest.

**N81#1.** Which of the following is required for a firm to designate itself "Member of the American Institute of Certified Public Accountants" on its letterhead?

- a. At least one of the partners must be a member.
- b. The partners whose names appear in the firm name must be members.
- c. All partners must be members.
- d. The firm must be a dues paying member.

**N81#5.** The AICPA Code of Professional Ethics provides, where a CPA is required to express an opinion on combined or consolidated financial statements which include a subsidiary, branch, or other component audited by another independent public accountant, that the CPA may

- a. Insist on auditing any such component which the CPA judges necessary to warrant the expression of an opinion.
- b. Insist only on performing a review of any such component.
- c. Not insist on auditing any such component but may request copies of all worksheets relevant to the other independent public accountant's examinations.
- d. Not insist on auditing any such component or reviewing worksheets belonging to the other independent public accountant.

**N81#19.** A CPA who performs primary actuarial services for a client would normally be precluded from expressing an opinion on the financial statements of that client if the

- a. Fees for the actuarial services have **not** been paid.
- b. Actuarial services are a major determinant of the pension expense.
- c. Client is an insurance company.
- d. Actuarial assumptions used are **not** in accordance with generally accepted auditing standards.

**N81#23.** Which of the following best describes what is meant by generally accepted auditing standards?

- a. Acts to be performed by the auditor.
- b. Measures of the quality of the auditor's performance.

## Auditing

- c. Procedures to be used to gather evidence to support financial statements.
- d. Audit objectives generally determined on audit engagements.

**M81#43.** Inclusion of which of the following statements in a CPA's advertisement is **not** acceptable pursuant to the AICPA Code of Professional Ethics?

- a. Paul Fall  
Certified Public Accountant  
Fluency in Spanish and French
- b. Paul Fall  
Certified Public Accountant  
J.D., Evans Law School 1964
- c. Paul Fall  
Certified Public Accountant  
Free Consultation
- d. Paul Fall  
Certified Public Accountant  
Endorsed by AICPA

**M81#48.** The third general standard states that due care is to be exercised in the performance of the examination. This standard should be interpreted to mean that a CPA who undertakes an engagement assumes a duty to perform

- a. With reasonable diligence and without fault or error.
- b. As a professional who will assume responsibility for losses consequent upon error of judgment.
- c. To the satisfaction of the client and third parties who may rely upon it.
- d. As a professional possessing the degree of skill commonly possessed by others in the field.

**M81#49.** Inclusion of which of the following in a promotional brochure published by a CPA firm would be most likely to result in a violation of the AICPA rules of conduct?

- a. Names and addresses, telephone numbers, number of partners, office hours, foreign language competence, and date the firm was established.
- b. Services offered and fees for such services, including hourly rates and fixed fees.
- c. Educational and professional attainments, including date and place of certification, schools attended, dates of graduation, degrees received, and memberships in professional associations.
- d. Names, addresses and telephone numbers of the firm's clients, including the number of years served.

**N80#5.** Auditing interpretations, which are issued by the staff of the AICPA Auditing Standards Division in order to provide timely guidance on the application of pronouncements of the Auditing Standards Board, are

- a. Less authoritative than a pronouncement of the Auditing Standards Board.
- b. Equally authoritative as a pronouncement of the Auditing Standards Board.
- c. More authoritative than a pronouncement of the Auditing Standards Board.
- d. Nonauthoritative opinions which are issued without consulting members of the Auditing Standards Board.

**N80#13.** According to the AICPA rules of conduct, contingent fees are permitted by CPAs engaged in tax practice because

- a. This practice establishes fees which are commensurate with the value of the services.
- b. Attorneys in tax practice customarily set contingent fees.
- c. Determinations by taxing authorities are a matter of judicial proceedings which do not involve third parties.
- d. The consequences are based upon findings of judicial proceedings or the findings of tax authorities.

**N80#26.** A CPA's retention of client records as a means of enforcing payment of an overdue audit fee is an action that is

- a. **Not** addressed by the AICPA Code of Professional Ethics.
- b. Acceptable if sanctioned by the state laws.
- c. Prohibited under the AICPA rules of conduct.
- d. A violation of generally accepted auditing standards.

**N80#37.** Which of the following statements best describes the phrase "generally accepted auditing standards"?

- a. They identify the policies and procedures for the conduct of the audit.
- b. They define the nature and extent of the auditor's responsibilities.
- c. They provide guidance to the auditor with respect to planning the audit and writing the audit report.
- d. They set forth a measure of the quality of the performance of audit procedures.

**N80#39.** The "generally accepted auditing standards" are standards which

- a. Are sufficiently established so that independent auditors generally agree on their existence.

*Selected Questions*

- b. Are generally accepted based upon a pronouncement of the Financial Accounting Standards Board.
  - c. Are generally accepted in response to the changing needs of the business community.
  - d. Are generally accepted as a consequence of approval of the AICPA membership.
- c. Information regarding administrative reprimands that were issued by the Division to individuals within the CPA firm.
  - d. Information regarding pending investigations of individuals within the CPA firm.

**N80#55.** The SEC has strengthened auditor independence by requiring that management

- a. Engage auditors to report in accordance with the Foreign Corrupt Practices Act.
- b. Report the nature of disagreements with former auditors.
- c. Select auditors through audit committees.
- d. Acknowledge their responsibility for the fairness of the financial statements.

**M80#39.** The concept of materiality would be least important to an auditor in determining the

- a. Transactions that should be reviewed.
- b. Need for disclosure of a particular fact or transaction.
- c. Scope of the CPA's audit program relating to various accounts.
- d. Effects of direct financial interest in the client upon the CPA's independence.

**B. Control of the Audit**

**N84#21.** Which of the following should an auditor obtain from the predecessor auditor prior to accepting an audit engagement?

- a. Analysis of balance sheet accounts.
- b. Analysis of income statement accounts.
- c. All matters of continuing accounting significance.
- d. Facts that might bear on the integrity of management.

**N84#55.** Anyone inquiring about the professional reputation and standing of a CPA firm may contact the AICPA Division for CPA Firms and expect to receive

- a. Copies of complaints against the CPA firm that are currently being adjudicated by the AICPA Trial Board.
- b. Copies of peer review reports on the CPA firm after the reports have been accepted by the Division.

**M84#8.** The least important evidence of a CPA firm's evaluation of its system of quality controls would concern the CPA firm's policies and procedures with respect to

- a. Employment (hiring).
- b. Confidentiality of audit engagements.
- c. Assigning personnel to audit engagements.
- d. Determination of audit fees.

**M84#33.** A difference of opinion concerning accounting and auditing matters relative to a particular phase of the audit arises between an assistant auditor and the auditor responsible for the engagement. After appropriate consultation, the assistant auditor asks to be disassociated from the resolution of the matter. The working papers would probably be

- a. Silent on the matter since it is an internal matter of the auditing firm.
- b. Expanded to note that the assistant auditor is completely disassociated from responsibility for the auditor's opinion.
- c. Expanded to document the additional work required, since all disagreements of this type will require expanded substantive testing.
- d. Expanded to document the assistant auditor's position, and how the difference of opinion was resolved.

**N83#40.** Which of the following situations would most likely require special audit planning by the auditor?

- a. Some items of factory and office equipment do not bear identification numbers.
- b. Depreciation methods used on the client's tax return differ from those used on the books.
- c. Assets costing less than \$500 are expensed even though the expected life exceeds one year.
- d. Inventory is comprised of precious stones.

**N83#48.** In connection with the element of inspection, a CPA firm's system of quality control should ordinarily provide for the maintenance of

- a. A file of minutes of staff meetings.
- b. Updated personnel files.
- c. Documentation to demonstrate compliance with its policies and procedures.
- d. Documentation to demonstrate compliance with peer review directives.

**M83#34.** A CPA establishes quality control policies and procedures for deciding whether to accept a new client or continue to perform services for a current client. The primary purpose for establishing such policies and procedures is

- a. To enable the auditor to attest to the integrity or reliability of a client.
- b. To comply with the quality control standards established by regulatory bodies.
- c. To lessen the exposure to litigation resulting from failure to detect irregularities in client financial statements.
- d. To minimize the likelihood of association with clients whose management lacks integrity.

**M83#44.** In determining estimates of fees, an auditor may take into account each of the following, **except** the

- a. Value of the service to the client.
- b. Degree of responsibility assumed by undertaking the engagement.
- c. Skills required to perform the service.
- d. Attainment of specific findings.

**M83#57.** Which of the following is **not** an element of quality control?

- a. Documentation.
- b. Inspection.
- c. Supervision.
- d. Consultation.

**N82#7.** What is the responsibility of a successor auditor with respect to communicating with the predecessor auditor in connection with a prospective new audit client?

- a. The successor auditor has **no** responsibility to contact the predecessor auditor.
- b. The successor auditor should obtain permission from the prospective client to contact the predecessor auditor.
- c. The successor auditor should contact the predecessor regardless of whether the prospective client authorizes contact.
- d. The successor auditor need **not** contact the predecessor if the successor is aware of all available relevant facts.

**N82#15.** In pursuing a CPA firm's quality control objectives, a CPA firm may maintain records indicating which partners or employees of the CPA firm were previously employed by the CPA firm's clients. Which quality control objective would this be **most** likely to satisfy?

- a. Professional relationship.
- b. Supervision.
- c. Independence.
- d. Advancement.

**M82#7.** The auditor will **not** ordinarily initiate discussion with the audit committee concerning the

- a. Extent to which the work of internal auditors will influence the scope of the examination.
- b. Extent to which change in the company's organization will influence the scope of the examination.
- c. Details of potential problems which the auditor believes might cause a qualified opinion.
- d. Details of the procedures which the auditor intends to apply.

**M82#35.** With respect to the auditor's planning of a year-end examination, which of the following statements is always true?

- a. An engagement should **not** be accepted after the fiscal year end.
- b. An inventory count must be observed at the balance sheet date.
- c. The client's audit committee should **not** be told of the specific audit procedures which will be performed.
- d. It is an acceptable practice to carry out substantial parts of the examination at interim dates.

**M82#47.** When negotiable securities are of considerable volume, planning by the auditor is necessary to guard against

- a. Unauthorized negotiation of the securities before they are counted.
- b. Unrecorded sales of securities after they are counted.
- c. Substitution of securities already counted for other securities which should be on hand but are **not**.
- d. Substitution of authentic securities with counterfeit securities.

**M82#59.** Williams & Co., a large international CPA firm, is to have an "external peer review." The peer review will most likely be performed by

- a. Employees and partners of Williams & Co. who are **not** associated with the particular audits being reviewed.
- b. Audit review staff of the Securities and Exchange Commission.
- c. Audit review staff of the American Institute of Certified Public Accountants.
- d. Employees and partners of another CPA firm.

**N81#13.** In planning an audit engagement, which of the following is a factor that affects the independent auditor's judgment as to the quantity, type, and content of working papers?

- a. The estimated occurrence rate of attributes.
- b. The preliminary evaluations based upon initial substantive testing.
- c. The content of the client's representation letter.
- d. The anticipated nature of the auditor's report.

## Selected Questions

**N81#14.** Hawkins requested permission to communicate with the predecessor auditor and review certain portions of the predecessor auditor's working papers. The prospective client's refusal to permit this will bear directly on Hawkins's decision concerning the

- Adequacy of the preplanned audit program.
- Ability to establish consistency in application of accounting principles between years.
- Apparent scope limitation.
- Integrity of management.

**M81#36.** In pursuing its quality control objectives with respect to acceptance of a client, a CPA firm is **not** likely to

- Make inquiries of the proposed client's legal counsel.
- Review financial statements of the proposed client.
- Make inquiries of previous auditors.
- Review the personnel practices of the proposed client.

**M81#58.** The independent auditor's plan for an examination in accordance with generally accepted auditing standards is influenced by the possibility of material errors. The auditor will therefore conduct the examination with an attitude of

- Professional skepticism.
- Subjective mistrust.
- Objective indifference.
- Professional responsiveness.

**N80#10.** A basic objective of a CPA firm is to provide professional services to conform with professional standards. Reasonable assurance of achieving this basic objective is provided through

- Continuing professional education.
- A system of quality control.
- Compliance with generally accepted reporting standards.
- A system of peer review.

**N80#48.** Rogers & Co., CPAs, policies require that all members of the audit staff submit weekly time reports to the audit manager, who then prepares a weekly summary work report regarding variance from budget for Rogers' review. This provides written evidence of Rogers & Co.'s professional concern regarding compliance with which of the following generally accepted auditing standards?

- Quality control.
- Due professional care.
- Adequate review.
- Adequate planning.

**N80#53.** It would **not** be appropriate for the auditor to initiate discussion with the audit committee concerning

- The extent to which the work of internal auditors will influence the scope of the examination.
- Details of the procedures which the auditor intends to apply.
- The extent to which change in the company's organization will influence the scope of the examination.
- Details of potential problems which the auditor believes might cause a qualified opinion.

**M80#32.** The understanding between the client and the auditor as to the degree of responsibilities to be assumed by each are normally set forth in a (an)

- Representation letter.
- Engagement letter.
- Management letter.
- Comfort letter.

**M80#58.** A CPA establishes quality control policies and procedures for deciding whether to accept a new client or continue to perform services for a current client. The primary purpose for establishing such policies and procedures is

- To enable the auditor to attest to the integrity or reliability of a client.
- To comply with the quality control standards established by regulatory bodies.
- To minimize the likelihood of association with clients whose managements lack integrity.
- To lessen the exposure to litigation resulting from failure to detect irregularities in client financial statements.

### C. Other Responsibilities

**N84#3.** In general, material irregularities perpetrated by which of the following are most difficult to detect?

- Cashier.
- Key-punch operator.
- Internal auditor.
- Controller.

**N84#20.** Which of the following, if material, would be an irregularity?

- Mistakes in the application of accounting principles.
- Clerical mistakes in the accounting data underlying the financial statements.
- Misappropriation of an asset or groups of assets.
- Misinterpretations of facts that existed when the financial statements were prepared.

## Auditing

**N84#43.** A CPA who is engaged to prepare an income tax return has a duty to prepare it in such a manner that the tax is

- The legal minimum.
- Computed in conformity with generally accepted accounting principles.
- Supported by the client's audited financial statements.
- Not subject to change upon audit.

**N84#45.** When unable to determine the amounts associated with certain illegal acts committed by a client, the auditor would most likely issue

- A review opinion with a separate explanatory paragraph.
- Only an adverse opinion.
- Either a qualified opinion or an adverse opinion.
- Either a qualified opinion or a disclaimer of opinion.

**N84#54.** The CPA who undertakes the performance of a management advisory service engagement should bear in mind that the results should

- Increase the client's earnings capabilities.
- Be communicated in quantitative terms.
- Not be set forth as quantitative estimates.
- Not be explicitly or implicitly guaranteed.

**M84#40.** During the course of an audit, the independent CPA is often called upon to give informal advice on many diverse questions. This type of service differs from management advisory services in that this type of service is informal and therefore

- The CPA does **not** make any warranties with respect to the competence of the extemporaneous advice.
- The CPA is **not** exposed to liability as a consequence of the extemporaneous advice.
- No presumption should exist that all pertinent facts have been identified and considered.
- No presumption should exist that the advice will impact upon the operations of the business enterprise.

**N83#11.** Pursuant to the AICPA's statements on responsibilities in tax practice, which of the following is **not** an acceptable manner of designating that an estimated figure was used in preparing a federal income tax return?

- Use a round amount.
- State expressly that an amount has been estimated.
- Use an amount suggested in a treasury department guideline.
- Modify the tax preparer's declaration on the return before signing the tax return.

**N83#23.** Which of the following statements regarding the examination of negotiable notes receivable is correct?

- Confirmation from the customer of a note is **not** an acceptable alternative to inspection.
- Notes receivable discounted without recourse are confirmed via the standard bank confirmation form used in the audit of cash.
- Physical inspection of a note by the auditor provides conclusive evidence.
- Notes receivable discounted with recourse need **not** be confirmed.

**N83#44.** If an illegal act is discovered during the audit of a publicly held company, the auditor should

- Notify the regulatory authorities.
- Determine who was responsible for the illegal act.
- Intensify the examination.
- Report the act to high level personnel within the client's organization.

**N83#49.** A management advisory service consultation, as opposed to a management advisory service engagement, generally involves advice or information given by a CPA that is based upon

- Existing personal knowledge about the client.
- An analytical approach and process.
- Information obtained during an examination of the client's financial statements.
- The results of an operational audit.

**N83#50.** The auditor is most likely to presume that a high risk of a defalcation exists if

- The client is a multinational company that does business in numerous foreign countries.
- The client does business with several related parties.
- Inadequate segregation of duties places an employee in a position to perpetrate and conceal thefts.
- Inadequate employee training results in lengthy EDP exception reports each month.

**N83#53.** Jones, CPA, prepared Smith's 1982 federal income tax return and appropriately signed the preparer's declaration. Several months later Jones learns that Smith improperly altered several figures before mailing the tax return to the IRS. Jones should communicate disapproval of this action to Smith and

- Take no further action with respect to the 1982 tax return but consider the implications of Smith's actions upon any future relationship.
- Inform the IRS of the unauthorized alteration.
- File an amended tax return.
- Refund any fee collected, return all relevant documents, and refuse any further association with Smith.



*Selected Questions*

**M83#60.** If the auditor considers an illegal act to be sufficiently serious to warrant withdrawing from the engagement, then the auditor should

- a. Notify all parties who may rely upon the company's financial statements of the company's illegal act.
- b. Consult with legal counsel as to what other action, if any, should be taken.
- c. Return all incriminating evidence and working papers to the client's audit committee for follow-up.
- d. Contact the successor auditor to make the successor aware of the possible consequences of relying on management's representations.

**M83#6.** An auditor who finds that the client has committed an illegal act would be most likely to withdraw from the engagement when the

- a. Illegal act affects the auditor's ability to rely on management representations.
- b. Illegal act has material financial statement implications.
- c. Illegal act has received widespread publicity.
- d. Auditor can **not** reasonably estimate the effect of the illegal act on the financial statements.

**M83#48.** Generally, the decision to notify parties outside the client's organization regarding an illegal act is the responsibility of the

- a. Independent auditor.
- b. Management.
- c. Outside legal counsel.
- d. Internal auditors.

**M83#56.** A CPA should **not** undertake a management advisory service engagement that includes continued participation through implementation, unless

- a. The CPA accepts overall responsibility for implementation of the chosen course of action.
- b. The CPA acquires an overall knowledge of the client's business that is equivalent to that possessed by management.
- c. Upon implementation the client's personnel will have the knowledge and ability to adequately maintain and operate such systems as may be involved.
- d. Upon implementation a new study and evaluation of the system of internal control is performed.

**M82#2.** An audit independence issue might be raised by the auditor's participation in management advisory services engagements. Which of the following statements is **most** consistent with the profession's attitude toward this issue?

- a. Information obtained as a result of a management advisory services engagement is confidential to that specific engagement and should **not** influence performance of the attest function.
- b. The decision as to loss of independence must be made by the client based upon the facts of the particular case.
- c. The auditor should **not** make management decisions for an audit client.
- d. The auditor who is asked to review management decisions is also competent to make these decisions and can do so without loss of independence.

**M82#45.** Which of the following is implied when a CPA signs the preparer's declaration on a federal income tax return?

- a. The tax return is **not** misleading based on all information of which the CPA has knowledge.
- b. The tax return and supporting schedules were prepared in accordance with generally accepted accounting principles.
- c. The tax return was examined in accordance with standards established by the AICPA's Federal Tax Division.
- d. The tax return was prepared by a CPA who maintained an impartial attitude.

**M82#53.** An auditor has withdrawn from an audit engagement of a publicly-held company after finding irregularities which may materially affect the financial statements. The auditor should set forth the reasons and findings in correspondence to the

- a. Securities and Exchange Commission.
- b. Client's legal counsel.
- c. Stock exchanges where the company's stock is traded.
- d. Board of directors.

**M82#11.** The Foreign Corrupt Practices Act requires that

- a. Auditors engaged to examine the financial statements of publicly-held companies report all illegal payments to the SEC.
- b. Publicly-held companies establish independent audit committees to monitor the effectiveness of their system of internal control.
- c. U.S. firms doing business abroad report sizable payments to non-U.S.-citizens to the Justice Department.
- d. Publicly-held companies devise and maintain an adequate system of internal accounting control.

**M82#34.** Within the context of quality control, the primary purpose of continuing professional education

## Auditing

and training activities is to enable a CPA firm to provide personnel within the firm with

- a. Technical training that assures proficiency as an auditor.
- b. Professional education that is required in order to perform with due professional care.
- c. Knowledge required to fulfill assigned responsibilities and to progress within the firm.
- d. Knowledge required in order to perform a peer review.

**M82#39.** When management refuses to disclose illegal activities which were identified by the independent auditor, the independent auditor may be charged with violating the AICPA Code of Professional Ethics for

- a. Withdrawing from the engagement.
- b. Issuing a disclaimer of opinion.
- c. Failure to uncover the illegal activities during prior audits.
- d. Reporting these activities to the audit committee.

**M82#52.** The preparer of a federal income tax return signs a preparer's declaration which states:

Under penalties of perjury, I declare that I have examined this return ... and to the best of my knowledge and belief it is true, correct, and complete.

A CPA who signs this declaration as preparer of a client's tax return warrants that

- a. Information furnished by the client was relied upon in preparing the tax return unless it appeared incorrect or incomplete.
- b. Information furnished by the client was examined in accordance with generally accepted auditing standards.
- c. All available evidence in support of material assertions on the tax return was examined in accordance with generally accepted auditing standards.
- d. All available evidence in support of material assertions on the tax return was documented in the CPA's working papers.

**N81#18.** The audit client's board of directors and audit committee refused to take any action with respect to an immaterial illegal act which was brought to their attention by the auditor. Because of their failure to act, the auditor withdrew from the engagement. The auditor's decision to withdraw was primarily due to doubts concerning

- a. Inadequate financial statement disclosures.
- b. Compliance with the Foreign Corrupt Practices Act.
- c. Scope limitations resulting from their inaction.
- d. Reliance on management's representations.

**N81#30.** When a CPA is associated with the preparation of forecasts, all of the following should be disclosed **except** the

- a. Sources of information.
- b. Character of the work performed by the CPA.
- c. Major assumptions in the preparation of the forecasts.
- d. Probability of achieving estimates.

**N81#45.** Which of the following conditions would **not** normally cause the auditor to question whether material errors or possible irregularities exist?

- a. Bookkeeping errors are listed on an EDP-generated exception report.
- b. Differences exist between control accounts and supporting subsidiary records.
- c. Transactions are **not** supported by proper documentation.
- d. Differences are disclosed by confirmations.

**M81#38.** In tax practice, which of the following would **not** be considered reasonable support for taking a position contrary to the Internal Revenue Code?

- a. Proposed regulations advocated by the IRS.
- b. Legal opinions as to the constitutionality of a specific provision.
- c. Possible conflicts between two sections of the Internal Revenue Code.
- d. Tax court decisions **not** acquiesced to by the IRS.

**M81#41.** Which of the following statements **best** describes the primary purpose of Statements on Auditing Standards?

- a. They are guides intended to set forth auditing procedures which are applicable to a variety of situations.
- b. They are procedural outlines which are intended to narrow the areas of inconsistency and divergence of auditor opinion.
- c. They are authoritative statements, enforced through the code of professional ethics, and are intended to limit the degree of auditor judgment.
- d. They are interpretations which are intended to clarify the meaning of "generally accepted auditing standards."

**M81#46.** To conceal defalcations involving receivables, the auditor would expect an experienced bookkeeper to charge which of the following accounts?

- a. Miscellaneous income.
- b. Petty cash.
- c. Miscellaneous expense.
- d. Sales returns.

**M81#56.** To establish illegal "slush funds," corporations may divert cash received in normal business op-

*Selected Questions*

erations. An auditor would encounter the greatest difficulty in detecting the diversion of proceeds from

- a. Scrap sales.
- b. Dividends.
- c. Purchase returns.
- d. C. O. D. sales.

**M81#57.** Which of the following statements best describes the auditor's responsibility with respect to illegal acts that do **not** have a material effect on the client's financial statements?

- a. Generally, the auditor is under no obligation to notify parties other than personnel within the client's organization.
- b. Generally, the auditor is under an obligation to see that stockholders are notified.
- c. Generally, the auditor is obligated to disclose the relevant facts in the auditor's report.
- d. Generally, the auditor is expected to compel the client to adhere to requirements of the Foreign Corrupt Practices Act.

**N80#4.** When a CPA prepares a federal income tax return for an audit client, one would expect

- a. The CPA to take a position of client advocacy.
- b. The CPA to take a position of independent neutrality.
- c. The taxable net income in the audited financial statements to agree with taxable net income in the federal income tax return.
- d. The expenses in the audited financial statements to agree with the deductions in the federal income tax return.

**N80#11.** Cortney has moved to a distant city but desires to continue to retain Blake, CPA, to prepare his personal federal tax return. Blake telephones Cortney after receiving his written list of information to be used in the preparation of the tax return because it appears to contain an understatement of interest expense. Based upon the conversation Blake learns that the interest expense should be double the amount indicated on the written list. Blake, who asked Cortney to send a photocopy of the supporting evidence indicating the correct amount of the interest expense, has not received the correspondence and the filing deadline is five days away. Under the circumstances Blake should

- a. Prepare the return based upon the written information received and **not** sign the preparer's declaration.
- b. Prepare the return based upon the written information received, clearly indicating that an amended return will follow.

- c. Prepare the return based upon the written and oral information received.
- d. Send Cortney a telegram indicating that no tax return will be prepared until all requested data are received.

**N80#33.** Which of the following is **not** a Management Advisory Service Practice Standard?

- a. In performing management advisory service, a practitioner must act with integrity and objectivity and be independent in mental attitude.
- b. The management advisory services engagement is to be performed by a person or persons having adequate technical training as a management consultant.
- c. Management advisory service engagements are to be performed by practitioners having competence in the analytical approach and process, and in the technical subject matter under consideration.
- d. Before undertaking a management advisory service engagement, a practitioner is to notify the client of any reservations regarding anticipated benefits.

**M80#2.** In accordance with the AICPA Statements On Responsibilities In Tax Practice, where a question on a federal income tax return has not been answered, the CPA should sign the preparer's declaration only if

- a. The CPA can provide reasonable support for this omission upon examination by IRS.
- b. The information requested is **not** available.
- c. The question is **not** applicable to the taxpayer.
- d. An explanation of the reason for the omission is provided.

**M80#22.** In accordance with the AICPA Statements On Responsibilities In Tax Practice, if after having provided tax advice to a client there are legislative changes which affect the advice provided, the CPA

- a. Is obligated to notify the client of the change and the effect thereof.
- b. Is obligated to notify the client of the change and the effect thereof if the client was not advised that the advice was based on existing laws which are subject to change.
- c. Can **not** be expected to notify the client of the change unless the obligation is specifically undertaken by agreement.
- d. Can **not** be expected to have knowledge of the change.

## II. Internal Control

### A. Definitions and Basic Concepts

**N84#15.** The preliminary phase of the auditor's review of internal control is designed to provide information on three matters. Which of the following is not a purpose of the preliminary review?

- Determine the extent to which EDP is used in significant accounting applications.
- Understand the flow of transactions in the system.
- Comprehend the basic structure of accounting control.
- Identify the controls on which reliance is planned.

**M84#5.** The auditor would be least likely to be concerned about internal control as it relates to

- Land and buildings.
- Common stock.
- Shareholder meetings.
- Minutes of board of directors meetings.

**M84#44.** Which of the following is the correct order of performing the auditing procedures A through C below?

- A = Compliance tests.  
B = Preparation of a flowchart depicting the client's system of internal control.  
C = Substantive tests.
- ABC
  - ACB
  - BAC
  - BCA

**N83#52.** Which of the following statements regarding auditor documentation of the client's system of internal control is correct?

- Documentation must include flow charts.
- Documentation must include procedural write-ups.
- No documentation is necessary although it is desirable.
- No one particular form of documentation is necessary, and the extent of documentation may vary.

**M83#16.** A secondary objective of the auditor's study and evaluation of internal control is that the study and evaluation provide

- A basis for constructive suggestions concerning improvements in internal control.
- A basis for reliance on the system of internal accounting control.
- An assurance that the records and documents have been maintained in accordance with existing company policies and procedures.
- A basis for the determination of the resultant extent of the tests to which auditing procedures are to be restricted.

**M83#22.** In general, a material internal control weakness may be defined as a condition in which material errors or irregularities would ordinarily not be detected within a timely period by

- An auditor during the normal study and evaluation of the system of internal control.
- A controller when reconciling accounts in the general ledger.
- Employees in the normal course of performing their assigned functions.
- The chief financial officer when reviewing interim financial statements.

**M83#24.** Assuming an excellent system of internal control exists, which of the following audit procedures would be least likely to be performed?

- Physical inspection of a sample of inventory.
- Search for unrecorded cash receipts.
- Obtain a client representation letter.
- Confirmation of accounts receivable.

**M83#39.** Which of the following would not be considered an internal control feature?

- Use of the double-entry system.
- An internal audit staff.
- Competent personnel.
- A comparison-shopping staff.

**M83#45.** Dickens, a CPA firm's personnel partner, periodically studies the CPA firm's personnel advancement experience to ascertain whether individuals meeting stated criteria are assigned increased degrees of responsibility. This is evidence of the CPA firm's adherence to prescribed

- Standards of due professional care.
- Quality control standards.
- Supervision and review standards.
- Standards of fieldwork.

Selected Questions

**M83#59.** Proper segregation of functional responsibilities calls for separation of the

- Authorization, recording, and custodial functions.
- Authorization, execution, and payment functions.
- Receiving, shipping, and custodial functions.
- Authorization, approval, and execution functions.

**M83#60.** Which of the following is an administrative control?

- Authorizing credit terms.
- Execution of transactions.
- Recording original data.
- Accountability over source data.

**N82#11.** The auditor is **least** concerned with which of the following?

- Administrative controls.
- Application controls.
- Safeguarding of assets.
- Access to assets.

**N82#24.** When considering internal control, an auditor must be aware of the concept of reasonable assurance which recognizes that the

- Employment of competent personnel provides assurance that the objectives of internal control will be achieved.
- Establishment and maintenance of a system of internal control is an important responsibility of the management and **not** of the auditor.
- Cost of internal control should **not** exceed the benefits expected to be derived from internal control.
- Segregation of incompatible functions is necessary to ascertain that the internal control is effective.

**N82#26.** Which of the following would be **least** likely to suggest to an auditor that the client's management may have overridden the internal control system?

- Differences are always disclosed on a computer exception report.
- Management does **not** correct internal control weaknesses that it knows about.
- There have been two new controllers this year.
- There are numerous delays in preparing timely internal financial reports.

**N82#51.** An auditor engaged to report on internal accounting control distinguishes between primary control procedures and secondary control procedures. Primary control procedures are designed to achieve one or more

specific objectives of a system of internal accounting control. Which of the following would be a primary control procedure?

- Comparison of receiving reports with vendor invoices prior to payment.
- Comparison of budgeted costs for direct labor with actual costs for direct labor.
- Comparison of actual costs for raw materials with standard costs for raw materials.
- Comparison of the cost of goods sold with credit sales.

**M82#24.** The use of fidelity bonds protects a company from embezzlement losses and also

- Minimizes the possibility of employing persons with dubious records in positions of trust.
- Reduces the company's need to obtain expensive business interruption insurance.
- Allows the company to substitute the fidelity bonds for various parts of internal accounting control.
- Protects employees who made unintentional errors from possible monetary damages resulting from such errors.

**M82#44.** Of the following statements about an internal control system, which one is **not** valid?

- No one person should be responsible for the custodial responsibility and the recording responsibility for an asset.
- Transactions must be properly authorized before such transactions are processed.
- Because of the cost/benefit relationship, a client may apply control procedures on a test basis.
- Control procedures reasonably insure that collusion among employees can **not** occur.

**N81#26.** After performing a study and evaluation of the client's system of internal control an auditor has concluded that the system is well designed and is functioning as anticipated. Under these circumstances the auditor would **most** likely

- Cease to perform further substantive tests.
- Not increase the extent of predetermined substantive tests.
- Increase the extent of anticipated analytical review procedures.
- Perform all compliance tests to the extent outlined in the preplanned audit program.

**M81#7.** The primary purpose of the auditor's study and evaluation of internal control is to provide a basis for

- Determining whether procedures and records that are concerned with the safeguarding of assets are reliable.

- b. Constructive suggestions to clients concerning improvements in internal control.
- c. Determining the nature, extent, and timing of audit tests to be applied.
- d. The expression of an opinion.

**M81#8.** The purpose of tests of compliance is to provide reasonable assurance that the

- a. Accounting treatment of transactions and balances is valid and proper.
- b. Accounting control procedures are functioning as intended.
- c. Entity has complied with disclosure requirements of generally accepted accounting principles.
- d. Entity has complied with requirements of quality control.

**M81#15.** Early appointment of the independent auditor will enable

- a. A more thorough examination to be performed.
- b. A proper study and evaluation of internal control to be performed.
- c. Sufficient competent evidential matter to be obtained.
- d. A more efficient examination to be planned.

**M81#22.** During the review of an EDP internal control system an auditor may review decision tables prepared by the client. A decision table is usually prepared by a client to supplement or replace the preparation of

- a. An internal control questionnaire when the number of alternative responses is large.
- b. A narrative description of a system where transactions are not processed in batches.
- c. Flowcharts when the number of alternatives is large.
- d. An internal control questionnaire not specifically designed for an EDP installation.

**M80#7.** Proper segregation of functional responsibilities calls for separation of the

- a. Authorization, approval, and execution functions.
- b. Authorization, execution, and payment functions.
- c. Receiving, shipping, and custodial functions.
- d. Authorization, recording, and custodial functions.

## **B. Study and Evaluation of the System**

**N84#42.** The auditor's review of the client's system of internal accounting control is documented in order to substantiate

- a. Conformity of the accounting records with generally accepted accounting principles.
- b. Compliance with generally accepted auditing standards.
- c. Adherence to requirements of management.
- d. The fairness of the financial statement presentation.

**M84#16.** Which of the following is **not** an auditing procedure that is commonly used in performing compliance tests?

- a. Inquiring
- b. Observing
- c. Confirming
- d. Inspecting

**M84#25.** When reviewing the system of internal control, the auditor would ordinarily prepare and obtain answers to an internal control questionnaire based upon a tentative flowchart of the system. The next step should ordinarily be to

- a. Determine the extent of audit work necessary to form an opinion.
- b. Arrive at a decision regarding the effectiveness of the internal control system.
- c. Gather enough evidence to determine if the internal control system is functioning as described.
- d. Make a preliminary evaluation of the internal control system assuming satisfactory compliance.

**M84#41.** After the study and evaluation of a client's system of internal accounting control has been completed, an auditor might decide to

- a. Increase the extent of compliance and substantive testing in areas where the system of internal accounting control is strong.
- b. Reduce the extent of compliance testing in areas where the system of internal accounting control is strong.
- c. Reduce the extent of both substantive and compliance testing in areas where the system of internal accounting control is strong.
- d. Increase the extent of substantive testing in areas where the system of internal accounting control is weak.

**N83#10.** Compliance testing is performed in order to determine whether or not

- a. Controls are functioning as designed.
- b. Necessary controls are absent.
- c. Incompatible functions exist.
- d. Material dollar errors exist.

**N83#15.** For good internal control, which of the following functions should **not** be the responsibility of the treasurer's department?

*Selected Questions*

- a. Data processing.
- b. Handling of cash.
- c. Custody of securities.
- d. Establishing credit policies.

**M83#42.** Which of the following internal control features would an auditor be **least** likely to review?

- a. Segregation of the asset-handling and record-keeping functions.
- b. Company policy regarding credit and collection efforts.
- c. Sales and cost records classified by products.
- d. Authorization of additions to plant and equipment.

**M83#43.** In the evaluation of internal accounting control, the auditor is basically concerned that the system provides reasonable assurance that

- a. Controls have **not** been circumvented by collusion.
- b. Errors have been prevented or detected.
- c. Operational efficiency has been achieved in accordance with management plans.
- d. Management **cannot** override the system.

**M83#7.** An auditor plans to examine a sample of 20 checks for countersignatures as prescribed by the client's internal control procedures. One of the checks in the chosen sample of 20 cannot be found. The auditor should consider the reasons for this limitation and

- a. Evaluate the results as if the sample size had been 19.
- b. Treat the missing check as a deviation for the purpose of evaluating the sample.
- c. Treat the missing check in the same manner as the majority of the other 19 checks, i.e., countersigned or not.
- d. Choose another check to replace the missing check in the sample.

**M83#20.** Which of the following would be **least** likely to be considered an objective of a system of internal control?

- a. Checking the accuracy and reliability of accounting data.
- b. Detecting management fraud.
- c. Encouraging adherence to managerial policies.
- d. Safeguarding assets.

**M83#21.** After a preliminary review of a client's EDP control, an auditor may decide not to perform compliance tests related to the control procedures within the EDP portion of the client's internal control system. Which of the following would **not** be a valid reason for choosing to omit compliance tests?

- a. The controls duplicate operative controls existing elsewhere in the system.

- b. There appear to be major weaknesses that would preclude reliance on the stated procedure.
- c. The time and dollar costs of testing exceed the time and dollar savings in substantive testing if the compliance tests show the controls to be operative.
- d. The controls appear adequate enough to be relied upon.

**M83#40.** After finishing the review phase of the study and evaluation of internal control in an audit engagement, the auditor should perform compliance tests on

- a. Those controls that the auditor plans to rely upon.
- b. Those controls in which material weaknesses were identified.
- c. Those controls that have a material effect upon the financial statement balances.
- d. A random sample of the controls that were reviewed.

**M82#9.** The auditor is examining copies of sales invoices only for the initials of the person responsible for checking the extensions. This is an example of a

- a. Compliance test.
- b. Substantive test.
- c. Dual purpose test.
- d. Test of balances.

**M82#14.** In a study of the system of internal control the completion of a questionnaire is most closely associated with which of the following?

- a. Separation of duties.
- b. Review of the system.
- c. Flowchart accuracy.
- d. Tests of compliance.

**M82#27.** The reliance placed on substantive tests in relation to the reliance placed on internal control varies in a relationship that is ordinarily

- a. Parallel.
- b. Inverse.
- c. Direct.
- d. Equal.

**M82#29.** An auditor will ordinarily ascertain whether payroll checks are properly endorsed during the examination of

- a. Time cards.
- b. The voucher system.
- c. Cash in bank.
- d. Accrued payroll.

**M82#8.** The auditor observes client employees during the review of the system of internal control in order to

- a. Prepare a flowchart.

## Auditing

- b. Update information contained in the organization and procedure manuals.
- c. Corroborate the information obtained during the initial review of the system.
- d. Determine the extent of compliance with quality control standards.

**M82#13.** Which of the following is ordinarily considered a compliance audit procedure?

- a. Send confirmation letters to banks.
- b. Count and list cash on hand.
- c. Examine signatures on checks.
- d. Obtain or prepare reconciliations of bank accounts as of the balance sheet date.

**M82#45.** The following are steps in the audit process:

- I. Prepare flowchart.
- II. Gather exhibits of all documents.
- III. Interview personnel.

The most logical sequence of steps is

- a. I, II, III.
- b. I, III, II.
- c. III, II, I.
- d. II, I, III.

**M82#46.** Which of the following sampling methods is most useful to auditors when testing for compliance?

- a. Stratified random sampling.
- b. Attribute sampling.
- c. Variable sampling.
- d. Unrestricted random sampling with replacement.

**N81#3.** A conceptually logical approach to the auditor's evaluation of accounting controls consists of the following four steps:

- I. Determine the accounting control procedures that should prevent or detect errors and irregularities.
- II. Evaluate any weakness to determine its effect on the nature, timing or extent of auditing procedures to be applied and suggestions to be made to the client.
- III. Determine whether the necessary procedures are prescribed and are being followed satisfactorily.
- IV. Consider the types of errors and irregularities that could occur.

What should be the order in which these four steps are performed?

- a. I, II, III, and IV.
- b. I, III, IV, and II.
- ✓ c. III, IV, I, and II.
- d. IV, I, III, and II.

**N81#6.** Which of the following would be **inappropriate** during a preliminary evaluation of the system of internal control?

- a. Completion of an internal control questionnaire.
- b. Use of attribute sampling.
- c. Oral inquiries.
- d. Review of an accounting manual prepared by the client.

**N81#16.** An internal control questionnaire indicates that an approved receiving report is required to accompany every check request for payment of merchandise. Which of the following procedures provides the **greatest** assurance that this control is operating effectively?

- a. Select and examine receiving reports and ascertain that the related cancelled checks are dated **no earlier** than the receiving reports.
- b. Select and examine receiving reports and ascertain that the related cancelled checks are dated **no later** than the receiving reports.
- c. Select and examine cancelled checks and ascertain that the related receiving reports are dated **no earlier** than the checks.
- d. Select and examine cancelled checks and ascertain that the related receiving reports are dated **no later** than the checks.

**M81#50.** An auditor's flowchart of a client's internal control system is a diagrammatic representation which depicts the auditor's

- a. Understanding of the system.
- b. Program for compliance tests.
- c. Documentation of the study and evaluation of the system.
- d. Understanding of the types of irregularities which are probable, given the present system.

**M81#60.** The objective of precision in sampling for compliance testing on an internal control system is to

- a. Determine the probability of the auditor's conclusion based upon reliance factors.
- b. Determine that financial statements taken as a whole are not materially in error.
- c. Estimate the reliability of substantive tests.
- d. Estimate the range of procedural deviations in the population.

**N80#2.** Which of the following would be **least** likely to be included in an auditor's tests of compliance?

- a. Inspection.
- b. Observation.
- c. Inquiry.
- d. Confirmation.

**N80#8.** Tests of compliance are concerned primarily with each of the following questions **except**

- a. How were the procedures performed?



Selected Questions

- b. Why were the procedures performed?
- c. Were the necessary procedures performed?
- d. By whom were the procedures performed?

**N80#12.** The auditor's preliminary understanding of the client's EDP system is primarily obtained by

- a. Inspection.
- b. Observation.
- c. Inquiry.
- d. Evaluation.

**N80#14.** A decision table is most closely associated with which of the following auditor functions?

- a. Preparation of a generalized EDP computer audit program.
- b. Preliminary review of the client's system of internal control.
- c. Performance of tests of balances and transactions.
- d. Preparation of an audit program.

**N80#44.** An auditor evaluates the existing system of internal control in order to

- a. Determine the extent of compliance tests which must be performed.
- b. Determine the extent of substantive tests which must be performed.
- c. Ascertain whether irregularities are probable.
- d. Ascertain whether any employees have incompatible functions.

**M80#41.** It is important for the CPA to consider the competence of the audit clients' employees because their competence bears directly and importantly upon the

- a. Cost/benefit relationship of the system of internal control.
- b. Achievement of the objectives of the system of internal control.
- c. Comparison of recorded accountability with assets.
- d. Timing of the tests to be performed.

**M80#47.** Which of the following audit tests would be regarded as a test of "compliance"?

- a. Tests of the specific items making up the balance in a given general ledger account.
- b. Tests of the inventory pricing to vendors' invoices.
- c. Tests of the signatures on cancelled checks to board of directors' authorizations.
- d. Tests of the additions to property, plant, and equipment by physical inspections.

**M80#50.** Which of the following is essential to determine whether the necessary internal control procedures were prescribed and are being followed?

- a. Developing questionnaires and checklists.
- b. Studying and evaluating administrative control policies.
- c. Reviewing the system and testing compliance.
- d. Observing employee functions and making inquiries.

**C. Cycles**

**N84#36.** To improve accountability for fixed asset retirements, management most likely would implement a system of internal control that includes

- a. Continuous analysis of the repairs and maintenance account.
- b. Periodic inquiry of plant executives by internal auditors as to whether any plant assets have been retired.
- c. Continuous utilization of serially numbered retirement work orders.
- d. Periodic inspection of insurance policies by the internal auditors.

**N84#44.** For effective internal control purposes, which of the following individuals should be responsible for mailing signed checks?

- a. Receptionist.
- b. Treasurer.
- c. Accounts payable clerk.
- d. Payroll clerk.

**N84#48.** In updating a computerized accounts receivable file, which one of the following would be used as a batch control to verify the accuracy of posting cash remittances?

- a. The sum of net sales.
- b. The sum of cash deposits less discounts taken by customers.
- c. The sum of cash deposits plus discounts taken by customers.
- d. The sum of net sales plus discounts taken by customers.

**M84#34.** The auditor is most likely to seek information from the plant manager with respect to the

- a. Adequacy of the provision for uncollectible accounts.
- b. Appropriateness of physical inventory observation procedures.
- c. Existence of obsolete machinery.
- d. Deferral of procurement of certain necessary insurance coverage.

**M84#47.** In a properly designed internal accounting control system, the same employee should **not** be permitted to

- a. Sign checks and cancel supporting documents.

## Auditing

- b. Receive merchandise and prepare a receiving report.
- c. Prepare disbursement vouchers and sign checks.
- d. Initiate a request to order merchandise and approve merchandise received.

**M84#48.** The proper use of prenumbered termination notice forms by the payroll department should provide assurance that all

- a. Uncashed payroll checks were issued to employees who have **not** been terminated.
- b. Personnel files are kept up to date.
- c. Employees who have **not** been terminated receive their payroll checks.
- d. Terminated employees are removed from the payroll.

**M84#56.** A well functioning system of internal control over the inventory/production functions would provide that finished goods are to be accepted for stock only after presentation of a completed production order and a (an)

- a. Shipping order.
- b. Material requisition
- c. Bill of lading.
- d. Inspection report.

**N83#6.** From the auditor's point of view, inventory counts are more acceptable prior to the year end when

- a. Internal control is weak.
- b. Accurate perpetual inventory records are maintained.
- c. Inventory is slow-moving.
- d. Significant amounts of inventory are held on a consignment basis.

**N83#20.** Unrecorded liabilities are most likely to be found during the review of which of the following documents?

- a. Unpaid bills.
- b. Shipping records.
- c. Bills of lading.
- d. Unmatched sales invoices.

**N83#38.** The **least** crucial element of internal control over cash is

- a. Separation of cash record-keeping from custody of cash.
- b. Preparation of the monthly bank reconciliation.
- c. Batch processing of checks.
- d. Separation of cash receipts from cash disbursements.

**M83#15.** Which of the following is **not** a universal rule for achieving strong internal control over cash?

- a. Separate the cash-handling and record-keeping functions.
- b. Decentralize the receiving of cash as much as possible.
- c. Deposit each day's cash receipts by the end of the day.
- d. Have bank reconciliations performed by employees independent with respect to handling cash.

**M83#23.** Which of the following sets of duties would ordinarily be considered basically incompatible in terms of good internal control?

- a. Preparation of monthly statements to customers and maintenance of the accounts receivable subsidiary ledger.
- b. Posting to the general ledger and approval of additions and terminations relating to the payroll.
- c. Custody of unmailed signed checks and maintenance of expense subsidiary ledgers.
- d. Collection of receipts on account and maintaining accounts receivable records.

**N82#3.** At which point in an ordinary sales transaction of a wholesaling business would a lack of specific authorization be of **least** concern to the auditor in the conduct of an audit?

- a. Granting of credit.
- b. Shipment of goods.
- c. Determination of discounts.
- d. Selling of goods for cash.

**N82#19.** When a customer fails to include a remittance advice with a payment, it is a common practice for the person opening the mail to prepare one. Consequently, mail should be opened by which of the following four company employees?

- a. Credit manager.
- b. Receptionist.
- c. Sales manager.
- d. Accounts receivable clerk.

**M82#18.** Budd, the purchasing agent of Lake Hardware Wholesalers, has a relative who owns a retail hardware store. Budd arranged for hardware to be delivered by manufacturers to the retail store on a C.O.D. basis, thereby enabling his relative to buy at Lake's wholesale prices. Budd was probably able to accomplish this because of Lake's poor internal control over

- a. Purchase requisitions.
- b. Cash receipts.
- c. Perpetual inventory records.
- d. Purchase orders.

*Selected Questions*

**M82#32.** To minimize the opportunities for fraud, unclaimed cash payroll should be

- a. Deposited in a safe deposit box.
- b. Held by the payroll custodian.
- c. Deposited in a special bank account.
- d. Held by the controller.

**M82#38.** Which of the following accounts should be reviewed by the auditor to gain reasonable assurance that additions to property, plant, and equipment are **not** understated?

- a. Depreciation.
- b. Accounts payable.
- c. Cash.
- d. Repairs.

**M82#51.** For effective internal control, the billing function should be performed by the

- a. Accounting department.
- b. Sales department.
- c. Shipping department.
- d. Credit and collection department.

**M82#55.** A large retail enterprise has established a policy which requires that the paymaster deliver all unclaimed payroll checks to the internal auditing department at the end of each payroll distribution day. This policy was **most** likely adopted in order to

- a. Assure that employees who were absent on a payroll distribution day are **not** paid for that day.
- b. Prevent the paymaster from cashing checks which are unclaimed for several weeks.
- c. Prevent a bona fide employee's check from being claimed by another employee.
- d. Detect any fictitious employee who may have been placed on the payroll.

**M82#57.** Apex Manufacturing Corporation mass produces eight different products. The controller who is interested in strengthening internal controls over the accounting for materials used in production would be most likely to implement

- a. An economic order quantity (EOQ) system.
- b. A job order cost accounting system.
- c. A perpetual inventory system.
- d. A separation of duties among production personnel.

**N81#4.** Jones was engaged to examine the financial statements of Gamma Corporation for the year ended June 30, 1980. Having completed an examination of the

investment securities, which of the following is the **best** method of verifying the accuracy of recorded dividend income?

- a. Tracing recorded dividend income to cash receipts records and validated deposit slips.
- b. Utilizing analytical review techniques and statistical sampling.
- c. Comparing recorded dividends with amounts appearing on federal information forms 1099.
- d. Comparing recorded dividends with a standard financial reporting service's record of dividends.

**N81#15.** Which one of the following would the auditor consider to be an incompatible operation if the cashier receives remittances from the the mailroom?

- a. The cashier prepares the daily deposit.
- b. The cashier makes the daily deposit at a local bank.
- c. The cashier posts the receipts to the accounts receivable subsidiary ledger cards.
- d. The cashier endorses the checks.

**N81#39.** For several years a client's physical inventory count has been lower than what was shown on the books at the time of the count so that downward adjustments to the inventory account were required. Contributing to the inventory problem could be weaknesses in internal control that led to the failure to record some

- a. Purchases returned to vendors.
- b. Sales returns received.
- c. Sales discounts allowed.
- d. Cash purchases.

**M81#9.** A sales cutoff test of billings complements the verification of

- a. Sales returns.
- b. Cash.
- c. Accounts receivable.
- d. Sales allowances.

**M81#28.** A common audit procedure in the audit of payroll transactions involves tracing selected items from the payroll journal to employee time cards that have been approved by supervisory personnel. This procedure is designed to provide evidence in support of the audit proposition that

- a. Only bona fide employees worked and their pay was properly computed.
- b. Jobs on which employees worked were charged with the appropriate labor cost.
- c. Internal controls relating to payroll disbursements are operating effectively.
- d. All employees worked the number of hours for which their pay was computed.

## Auditing

**M81#51.** In the audit of which of the following types of profit-oriented enterprises would the auditor be most likely to place special emphasis on testing the internal controls over proper classification of payroll transactions?

- A manufacturing organization.
- A retailing organization.
- A wholesaling organization.
- A service organization.

**M81#59.** When evaluating inventory controls with respect to segregation of duties, a CPA would be **least** likely to

- Inspect documents.
- Make inquiries.
- Observe procedures.
- Consider policy and procedure manuals.

**N80#35.** With respect to an internal control measure that will assure accountability for fixed asset retirements, management should implement a system that includes

- Continuous analysis of miscellaneous revenue to locate any cash proceeds from sale of plant assets.
- Periodic inquiry of plant executives by internal auditors as to whether any plant assets have been retired.
- Continuous utilization of serially numbered retirement work orders.
- Periodic observation of plant assets by the internal auditors.

**N80#40.** Which of the following is a primary function of the purchasing department?

- Authorizing the acquisition of goods.
- Ensuring the acquisition of goods of a specified quality.
- Verifying the propriety of goods acquired.
- Reducing expenditures for goods acquired.

**N80#52.** Which of the following procedures would best detect the theft of valuable items from an inventory that consists of hundreds of different items selling for \$1 to \$10 and a few items selling for hundreds of dollars?

- Maintain a perpetual inventory of only the more valuable items with frequent periodic verification of the validity of the perpetual inventory record.
- Have an independent CPA firm prepare an internal control report on the effectiveness of the administrative and accounting controls over inventory.
- Have separate warehouse space for the more valuable items with sequentially numbered tags.
- Require an authorized officer's signature on all requisitions for the more valuable items.

**M80#56.** Propex Corporation uses a voucher register and does **not** record invoices in a subsidiary ledger. Propex will probably benefit most from the additional cost of maintaining an accounts payable subsidiary ledger if

- There are usually invoices in an unmatched invoice file.
- Vendors' requests for confirmation of receivables often go unanswered for several months until paid invoices can be reviewed.
- Partial payments to vendors are continuously made in the ordinary course of business.
- It is difficult to reconcile vendors' monthly statements.

### D. Other Considerations

**N84#9.** An EDP input control is designed to ensure that

- Machine processing is accurate.
- Only authorized personnel have access to the computer area.
- Data received for processing are properly authorized and converted to machine readable form.
- Electronic data processing has been performed as intended for the particular application.

**N84#10.** Carmela Department Stores has a fully integrated EDP accounting system and is planning to issue credit cards to credit-worthy customers. To strengthen internal control by making it difficult for one to create a valid customer account number, the company's independent auditor has suggested the inclusion of a check digit which should be placed

- At the beginning of a valid account number, only.
- In the middle of a valid account number, only.
- At the end of a valid account number, only.
- Consistently in any position.

**N84#16.** When a data base administrator's position exists within a client organization, the auditor must be aware of the

- Output effectiveness/efficiency considerations.
- Need for coded program files.
- Use of encrypted dialog in a two-way authentication process.
- Inherent violation of the principle of separation of duties.

**N84#32.** In assessing sampling risk, the risk of incorrect rejection and the risk of underreliance on internal accounting control relate to the

- Efficiency of the audit.
- Effectiveness of the audit.

Selected Questions

- c. Selection of the sample.
- d. Audit quality controls.

**N84#39.** An auditor's report on internal control of a publicly held company would ordinarily be of least use to

- a. Shareholders.
- b. Officers.
- c. Directors.
- d. Regulatory agencies.

**N84#57.** Given random selection, the same sample size, and the same precision requirement for the testing of two unequal populations, the risk of overreliance on the smaller population is

- a. The same as the risk of overreliance on the larger population.
- b. Higher than the risk of overreliance on the larger population.
- c. Lower than the risk of overreliance on the larger population.
- d. Indeterminable relative to the risk of overreliance on the larger population.

**M84#10.** At times a sample may indicate that the auditor's planned degree of reliance on a given control is reasonable when, in fact, the true compliance rate does not justify such reliance. This situation illustrates the risk of

- a. Overreliance.
- b. Underreliance.
- c. Incorrect precision.
- d. Incorrect rejection.

**M84#13.** Which of the following constitutes a weakness in the internal control of an EDP system?

- a. One generation of backup files is stored in an off-premises location.
- b. Machine operators distribute error messages to the control group.
- c. Machine operators do **not** have access to the complete systems manual.
- d. Machine operators are supervised by the programmer.

**M84#14.** One of the major problems in an EDP system is that incompatible functions may be performed by the same individual. One compensating control for this is the use of

- a. Echo checks.
- b. A self-checking digit system.
- c. Computer generated hash totals.
- d. A computer log.

**M84#15.** First Federal S & L has an on-line real-time system, with terminals installed in all of its branches. This system will not accept a customer's cash with-

drawal instructions in excess of \$1,000 without the use of a "terminal audit key." After the transaction is authorized by a supervisor, the bank teller then processes the transaction with the audit key. This control can be strengthened by

- a. On-line recording of the transaction on an audit override sheet.
- b. Increasing the dollar amount to \$1,500.
- c. Requiring manual, rather than on-line, recording of all such transactions.
- d. Using parallel simulation.

**M84#20.** The accountant's report expressing an opinion on an entity's system of internal accounting control should state that the

- a. Establishment and maintenance of the system of internal control are the responsibility of management.
- b. Objectives of the client's system of internal accounting control are being met.
- c. Study and evaluation of the system of internal control was conducted in accordance with generally accepted auditing standards.
- d. Inherent limitations of the client's system of internal accounting control were examined.

**M84#24.** Totals of amounts in computer-record data fields which are **not** usually added for other purposes but are used only for data processing control purposes are called

- a. Record totals.
- b. Hash totals.
- c. Processing data totals.
- d. Field totals.

**M84#32.** When erroneous data are detected by computer program controls, such data may be excluded from processing and printed on an error report. This error report should be reviewed and followed up by the

- a. Computer operator.
- b. Systems analyst.
- c. EDP control group.
- d. Computer programmer.

**M84#37.** The accountant's report expressing an opinion on an entity's system of internal accounting control would **not** include a

- a. Description of the scope of the engagement.
- b. Specific date that the report covers, rather than a period of time.
- c. Brief explanation of the broad objectives and inherent limitations of internal accounting control.
- d. Statement that the entity's system of internal accounting control is consistent with that of the prior year after giving effect to subsequent changes.

## Auditing

**N84#55.** A well-prepared flowchart should make it easier for the auditor to

- a. Prepare audit procedure manuals.
- b. Prepare detailed job descriptions.
- c. Trace the origin and disposition of documents.
- d. Assess the degree of accuracy of financial data.

**N83#3.** The machine language for a specific computer

- a. May be changed by the programmer.
- b. Is the same as all other computer languages.
- c. Is determined by the engineers who designed the computer.
- d. Is always alphabetic.

**N83#4.** Hitech, Inc., has changed from a conventional to a computerized payroll clock card system. Factory employees now record time in and out with magnetic cards and the EDP system automatically updates all payroll records. Because of this change

- a. The auditor must audit through the computer.
- b. Internal control has improved.
- c. Part of the audit trail has been lost.
- d. The potential for payroll related fraud has been diminished.

**N83#7.** Which of the following is an element of sampling risk?

- a. Choosing an audit procedure that is inconsistent with the audit objective.
- b. Choosing a sample size that is too small to achieve the sampling objective.
- c. Failing to detect an error on a document that has been inspected by the auditor.
- d. Failing to perform audit procedures that are required by the sampling plan.

**N83#12.** If the achieved precision range of a statistical sample at a given reliability level is greater than the desired range, this is an indication that the

- a. Standard deviation was larger than expected.
- b. Standard deviation was less than expected.
- c. Population was larger than expected.
- d. Population was smaller than expected.

**N83#21.** Which of the following is likely to be of least importance to an auditor in reviewing the internal control in a company with automated data processing?

- a. The segregation of duties within the EDP center.
- b. The control over source documents.
- c. The documentation maintained for accounting applications.
- d. The cost/benefit ratio of data processing operations.

**N83#22.** In the weekly computer run to prepare payroll checks, a check was printed for an employee who

had been terminated the previous week. Which of the following controls, if properly utilized, would have been most effective in preventing the error or ensuring its prompt detection?

- a. A control total for hours worked, prepared from time cards collected by the timekeeping department.
- b. Requiring the treasurer's office to account for the numbers of the prenumbered checks issued to the EDP department for the processing of the payroll.
- c. Use of a check digit for employee numbers.
- d. Use of a header label for the payroll input sheet.

**N83#27.** Auditing by testing the input and output of an EDP system instead of the computer program itself will

- a. Not detect program errors which do not show up in the output sampled.
- b. Detect all program errors, regardless of the nature of the output.
- c. Provide the auditor with the same type of evidence.
- d. Not provide the auditor with confidence in the results of the auditing procedures.

**N83#32.** An auditor examining inventory may appropriately apply sampling for attributes in order to estimate the

- a. Average price of inventory items.
- b. Percentage of slow-moving inventory items.
- c. Dollar value of inventory.
- d. Physical quantity of inventory items.

**N83#34.** A CPA's study and evaluation of the system of internal accounting control in an audit

- a. Is generally more limited than that made in connection with an engagement to express an opinion on the system of internal accounting control.
- b. Is generally more extensive than that made in connection with an engagement to express an opinion on the system of internal accounting control.
- c. Will generally be identical to that made in connection with an engagement to express an opinion on the system of internal accounting control.
- d. Will generally result in the CPA expressing an opinion on the system of internal accounting control.

**N83#35.** Which of the following best describes how the detailed audit program of the CPA who is engaged to audit the financial statements of a large publicly held company compares with the audit client's comprehensive internal audit program?

*Selected Questions*

- a. The comprehensive internal audit program is more detailed and covers areas that would normally **not** be reviewed by the CPA.
- b. The comprehensive internal audit program is more detailed although it covers less areas than would normally be covered by the CPA.
- c. The comprehensive internal audit program is substantially identical to the audit program used by the CPA because both review substantially identical areas.
- d. The comprehensive internal audit program is less detailed and covers less areas than would normally be reviewed by the CPA.

**M83#41.** When testing a computerized accounting system, which of the following is **not** true of the test data approach?

- a. Test data are processed by the client's computer programs under the auditor's control.
- b. The test data must consist of all possible valid and invalid conditions.
- c. The test data need consist of only those valid and invalid conditions in which the auditor is interested.
- d. Only one transaction of each type need be tested.

**M83#2.** The tolerable rate of deviations for a compliance test is generally

- a. Lower than the expected rate of errors in the related accounting records.
- b. Higher than the expected rate of errors in the related accounting records.
- c. Identical to the expected rate of errors in the related accounting records.
- d. Unrelated to the expected rate of errors in the related accounting records.

**M83#5.** If the auditor is concerned that a population may contain exceptions, the determination of a sample size sufficient to include at **least** one such exception is a characteristic of

- a. Discovery sampling.
- b. Variables sampling.
- c. Random sampling.
- d. Dollar-unit sampling.

**M83#6.** Which of the following best illustrates the concept of sampling risk?

- a. A randomly chosen sample may **not** be representative of the population as a whole on the characteristic of interest.
- b. An auditor may select audit procedures that are **not** appropriate to achieve the specific objective.

- c. An auditor may fail to recognize errors in the documents examined for the chosen sample.
- d. The documents related to the chosen sample may **not** be available for inspection.

**M83#35.** When an on-line, real-time (OLRT) electronic data processing system is in use, internal control can be strengthened by

- a. Providing for the separation of duties between keypunching and error listing operations.
- b. Attaching plastic file protection rings to reels of magnetic tape before new data can be entered on the file.
- c. Making a validity check of an identification number before a user can obtain access to the computer files.
- d. Preparing batch totals to provide assurance that file updates are made for the entire input.

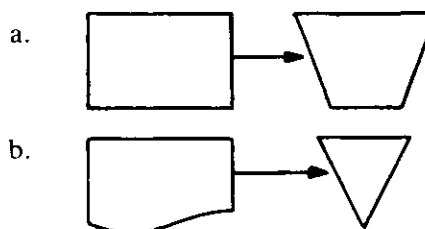
**M83#41.** In connection with the examination of financial statements by an independent auditor, the client suggests that members of the internal audit staff be utilized to minimize audit costs. Which of the following tasks could most appropriately be delegated to the internal audit staff?

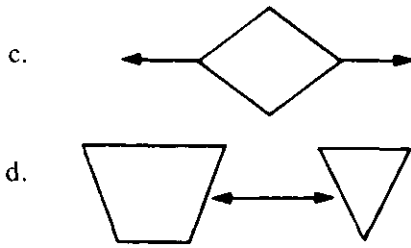
- a. Selection of accounts receivable for confirmation, based upon the internal auditor's judgment as to how many accounts and which accounts will provide sufficient coverage.
- b. Preparation of schedules for negative accounts receivable responses.
- c. Evaluation of the internal control for accounts receivable and sales.
- d. Determination of the adequacy of the allowance for doubtful accounts.

**M83#47.** If a control total were to be computed on each of the following data items, which would best be identified as a hash total for a payroll EDP application?

- a. Net pay.
- b. Department numbers.
- c. Hours worked.
- d. Total debits and total credits.

**M83#54.** Which of the following symbolic representations indicate that a file has been consulted?





**N82#32.** One of the major problems in an EDP system is that incompatible functions may be performed by the same individual. One compensating control for this is use of

- A tape library.
- A self-checking digit system.
- Computer generated hash totals.
- A computer log.

**N82#38.** Which of the following is **not** a characteristic of a batch-processed computer system?

- The collection of like transactions which are sorted and processed sequentially against a master file.
- Keypunching of transactions, followed by machine processing.
- The production of numerous printouts.
- The posting of a transaction, as it occurs, to several files, without intermediate printouts.

**N82#42.** The auditor who becomes aware of a material weakness in internal control is required to communicate this to the

- Audit committee and client's legal counsel.
- Board of directors and internal auditors.
- Senior management and board of directors.
- Internal auditors and senior management.

**N82#50.** Which of the following would **lessen** internal control in an electronic data processing system?

- The computer librarian maintains custody of computer program instructions and detailed program listings.
- Computer operators have access to operator instructions and detailed program listings.
- The control group maintains sole custody of all computer output.
- Computer programmers write and debug programs which perform routines designed by the systems analyst.

**N82#54.** In attribute sampling, a 10% change in which of the following factors normally will have the **least** effect on the size of a statistical sample?

- Population size.
- Precision (confidence interval).
- Reliability (confidence level).
- Standard deviation.

**N82#59.** When an auditor issues an unqualified opinion on an entity's system of internal accounting control, it is implied that the

- Entity has **not** violated provisions of the Foreign Corrupt Practices Act.
- Likelihood of management fraud is minimal.
- Financial records are sufficiently reliable to permit the preparation of financial statements.
- Entity's system of internal accounting control is in conformity with criteria established by its audit committee.

**M82#1.** If all other factors specified in an attribute sampling plan remain constant, changing the specified precision from 6% to 10%, and changing the specified reliability from 97% to 93%, would cause the required sample size to

- Increase.
- Remain the same.
- Decrease.
- Change by 4%.

**M82#2.** An auditor initially planned to use unrestricted random sampling with replacement in the examination of accounts receivable. Later, the auditor decided to use unrestricted random sampling without replacement. As a result only of this decision, the sample size should

- Increase.
- Remain the same.
- Decrease.
- Be recalculated using a binomial distribution.

**M82#5.** The precision limit for compliance tests necessary to justify reliance on internal accounting control depends primarily on which of the following?

- The cause of errors.
- The extent of reliance to be placed on the procedures.
- The amount of any substantive errors.
- The limit used in audits of similar clients.

**M82#42.** An auditor's report on internal accounting control is **least** likely to be issued as a result of a (an)

- Audit of the financial statements of a governmental agency.
- Review of the annual financial statements of a large corporation.
- Special study of a proposed system of internal accounting control.
- Special study of related party transactions.

**M82#54.** An independent auditor might consider the procedures performed by the internal auditors because

- They are employees whose work must be reviewed during substantive testing.



*Selected Questions*

- b. They are employees whose work might be relied upon.
- c. Their work impacts upon the cost/benefit tradeoff in evaluating inherent limitations.
- d. Their degree of independence may be inferred by the nature of their work.

**N81#7.** If the size of the sample to be used in a particular test of attributes has **not** been determined by utilizing statistical concepts, but the sample has been chosen in accordance with random selection procedures,

- a. No inferences can be drawn from the sample.
- b. The auditor has committed a nonsampling error.
- c. The auditor may or may **not** achieve desired precision at the desired level of confidence.
- d. The auditor will have to evaluate the results by reference to the principles of discovery sampling.

**N81#8.** Where disc files are used, the grandfather-father-son updating backup concept is relatively difficult to implement because the

- a. Location of information points on discs is an extremely time consuming task.
- b. Magnetic fields and other environmental factors cause off-site storage to be impractical.
- c. Information must be dumped in the form of hard copy if it is to be reviewed before used in updating.
- d. Process of updating old records is destructive.

**N81#10.** Which of the following is likely to be **least** important to an auditor who is reviewing the internal controls surrounding the automated data processing function?

- a. Ancillary program functions.
- b. Disposition of source documents.
- c. Operator competence.
- d. Bit storage capacity.

**N81#29.** When performing a compliance test with respect to control over cash disbursements, a CPA may use a systematic sampling technique with a start at any randomly selected item. The biggest disadvantage of this type of sampling is that the items in the population

- a. Must be recorded in a systematic pattern before the sample can be drawn.
- b. May occur in a systematic pattern, thus destroying the sample randomness.
- c. May systematically occur more than once in the sample.
- d. Must be systematically replaced in the population after sampling.

**N81#50.** Which of the following reports is an indication of the changing role of the CPA that calls for an extension of the auditor's attest function?

- a. Report on annual comparative financial statements.
- b. Report on internal control based on an audit.
- c. Report on separate balance sheet of a holding company.
- d. Report on balance sheet and statements of income, retained earnings, and changes in financial position prepared from incomplete financial records.

**N81#53.** Taylor Sales Corp. maintains a large full-time internal audit staff which reports directly to the chief accountant. Audit reports prepared by the internal auditors indicate that the system is functioning as it should and that the accounting records are reliable. The independent auditor will probably

- a. Eliminate compliance testing.
- b. Increase the depth of the study and evaluation of administrative controls.
- c. Avoid duplicating the work performed by the internal audit staff.
- d. Place limited reliance on the work performed by the internal audit staff.

**N81#55.** Which of the following statements with respect to required auditor communication of weaknesses in internal accounting controls is correct?

- a. Such communication is required to be in writing.
- b. Such communication must include a description of all weaknesses.
- c. Such communication is the principal reason for testing and evaluating internal controls.
- d. Such communication is incidental to the auditor's study and evaluation of the system of internal accounting control.

**M81#3.** An auditor should be familiar with a client's electronic data processing hardware and software. An important element of the client's software is the program. Another element of software is the

- a. Cathode ray tube (CRT).
- b. Central processing unit (CPU).
- c. Magnetic tape drive.
- d. Compiler.

**M81#6.** The computer system **most** likely to be used by a large savings bank for customers' accounts would be

- a. An on-line, real time system.
- b. A batch processing system.
- c. A generalized utility system.
- d. A direct access data base system.

## Auditing

**M81#20.** In the study and review of a client's EDP internal control system, the auditor will encounter general controls and application controls. Which of the following is an application control?

- a. Dual read.
- b. Hash total.
- c. Systems flowchart.
- d. Control over program changes.

**M81#34.** A procedural control used in the management of a computer center to minimize the possibility of data or program file destruction through operator error includes

- a. Control figures.
- b. Crossfooting tests.
- c. Limit checks.
- d. External labels.

**M81#35.** The use of a header label in conjunction with magnetic tape is **most** likely to prevent errors by the

- a. Computer operator.
- b. Keypunch operator.
- c. Computer programmer.
- d. Maintenance technician.

**M81#44.** When an independent auditor decides that the work performed by internal auditors may have a bearing on the nature, timing, and extent of contemplated audit procedures, the independent auditor should plan to evaluate the objectivity of the internal auditors. Relative to objectivity, the independent auditor should

- a. Consider the organization level to which internal auditors report the results of their work.
- b. Review the quality control program in effect for the internal audit staff.
- c. Examine the quality of the internal audit reports.
- d. Consider the qualifications of the internal audit staff.

**N80#43.** Jones, CPA, believes the industry-wide occurrence rate of client billing errors is 3% and has established a maximum acceptable occurrence rate of 5%. In the review of client invoices Jones should use

- a. Discovery sampling.
- b. Attribute sampling.
- c. Stratified sampling.
- d. Variable sampling.

**N80#47.** To replace the human element of error detection associated with manual processing, a well-designed automated system will introduce

- a. Dual circuitry.
- b. Programmed limits.
- c. Echo checks.
- d. Read after write.

**M80#10.** The program flowcharting symbol representing a decision is a

- a. Triangle.
- b. Circle.
- c. Rectangle.
- d. Diamond.

**M80#43.** The major reason that the difference and ratio estimation methods would be expected to produce audit efficiency is that the

- a. Number of members of the populations of differences or ratios is smaller than the number of members of the population of book values.
- b. Beta risk may be completely ignored.
- c. Calculations required in using difference or ratio estimation are less arduous and fewer than those required when using direct estimation.
- d. Variability of the populations of differences or ratios is less than that of the populations of book values or audited values.

**M80#59.** In updating a computerized accounts receivable file, which one of the following would be used as a batch control to verify the accuracy of the posting of cash receipts remittances?

- a. The sum of the cash deposits plus the discounts less the sales returns.
- b. The sum of the cash deposits.
- c. The sum of the cash deposits less the discounts taken by customers.
- d. The sum of the cash deposits plus the discounts taken by customers.

### III. Audit Evidence and Procedures

#### A. Audit Evidence

**N84#17.** A written representation from a client's management which, among other matters, acknowledges responsibility for the fair presentation of financial statements, should normally be signed by the

- Chief executive officer and the chief financial officer.
- Chief financial officer and the chairman of the board of directors.
- Chairman of the audit committee of the board of directors.
- Chief executive officer, the chairman of the board of directors, and the client's lawyer.

**N84#18.** To ascertain the exact name of the corporate client, the auditor relies primarily on

- Corporate minutes.
- Bylaws.
- Articles of incorporation.
- Tax returns.

**N84#24.** An auditor should perform alternative procedures to substantiate the existence of accounts receivable when

- No reply to a positive confirmation request is received.
- No reply to a negative confirmation request is received.
- Collectibility of the receivables is in doubt.
- Pledging of the receivables is probable.

**N84#26.** Which of the following ratios would be the **least** useful in reviewing the overall profitability of a manufacturing company?

- Net income to net worth.
- Net income to working capital.
- Net income to sales.
- Net income to total assets.

**N84#33.** In a manufacturing company, which one of the following audit procedures would give the **least** assurance of the valuation of inventory at the audit date?

- Testing the computation of standard overhead rates.
- Examining paid vendors' invoices.
- Reviewing direct labor rates.
- Obtaining confirmation of inventories pledged under loan agreements.

**N84#35.** Which of the following would be **least** likely to be comparable between similar corporations in the same industry line of business?

- Earnings per share.
- Return on total assets before interest and taxes.
- Accounts receivable turnover.
- Operating cycle.

**N84#40.** The auditor can best verify a client's bond sinking fund transactions and year-end balance by

- Confirmation with individual holders of retired bonds.
- Confirmation with the bond trustee.
- Recomputation of interest expense, interest payable, and amortization of bond discount or premium.
- Examination and count of the bonds retired during the year.

**N84#49.** Which one of the following is generally more important in a review than in a compilation?

- Determining the accounting basis on which the financial statements are to be presented.
- Gaining familiarity with industry accounting principles and practices.
- Obtaining a signed engagement letter.
- Obtaining a signed representation letter.

**N84#56.** If a lawyer refuses to furnish corroborating information regarding litigation, claims, and assessments, the auditor should

- Honor the confidentiality of the client-lawyer relationship.
- Consider the refusal to be tantamount to a scope limitation.
- Seek to obtain the corroborating information from management.
- Disclose this fact in a footnote to the financial statements.

**M84#2.** The auditor faces a risk that the examination will not detect material errors in the financial statements. In regard to minimizing this risk, the auditor primarily relies on

- Substantive tests.
- Compliance tests.
- Internal control.
- Statistical analysis.

**M84#6.** In the confirmation of accounts receivable the auditor would most likely

- a. Request confirmation of a sample of the inactive accounts.
- b. Seek to obtain positive confirmations for at least 50% of the total dollar amount of the receivables.
- c. Require confirmation of all receivables from agencies of the federal government.
- d. Require that confirmation requests be sent within one month of the fiscal year-end.

**M84#11.** Which of the following expressions is **least** likely to be included in a client's representation letter?

- a. No events have occurred subsequent to the balance sheet date that require adjustment to, or disclosure in, the financial statements.
- b. The company has complied with all aspects of contractual agreements that would have a material effect on the financial statements in the event of noncompliance.
- c. Management acknowledges responsibility for illegal actions committed by employees.
- d. Management has made available all financial statements and related data.

**M84#19.** Auditors may use positive and/or negative forms of confirmation requests for accounts receivable. An auditor most likely will use

- a. The positive form to confirm all balances regardless of size.
- b. A combination of the two forms, with the positive form used for large balances and the negative form for the small balances.
- c. A combination of the two forms, with the positive form used for trade receivables and the negative form for other receivables.
- d. The positive form when controls related to receivables are satisfactory, and the negative form when controls related to receivables are unsatisfactory.

**M84#22.** An auditor should obtain written representations from management concerning litigation claims and assessments. These representations may be limited to matters that are considered either individually or collectively material, provided an understanding on the limits of materiality for this purpose has been reached by

- a. The auditor and the client's lawyer.
- b. Management and the auditor.
- c. Management, the client's lawyer, and the auditor.
- d. The auditor independently of management.

**M84#23.** Of the following which is the **least** persuasive type of audit evidence?

- a. Documents mailed by outsiders to the auditor.
- b. Correspondence between auditor and vendors.
- c. Copies of sales invoices inspected by the auditor.
- d. Computations made by the auditor.

**M84#26.** As a result of analytical review procedures, the independent auditor determines that the gross profit percentage has declined from 30% in the preceding year to 20% in the current year. The auditor should

- a. Document management's intentions with respect to plans for reversing this trend.
- b. Evaluate management's performance in causing this decline.
- c. Require footnote disclosure.
- d. Consider the possibility of an error in the financial statements.

**M84#27.** The auditor notices significant fluctuations in key elements of the company's financial statements. If management is unable to provide an acceptable explanation, the auditor should

- a. Consider the matter a scope limitation.
- b. Perform additional audit procedures to investigate the matter further.
- c. Intensify the examination with the expectation of detecting management fraud.
- d. Withdraw from the engagement.

**M84#29.** Analytical review procedures are

- a. Substantive tests designed to evaluate a system of internal control.
- b. Compliance tests designed to evaluate the validity of management's representation letter.
- c. Substantive tests designed to evaluate the reasonableness of financial information.
- d. Compliance tests designed to evaluate the reasonableness of financial information.

**M84#31.** The auditor may refer to and identify a specialist in the auditor's report if the auditor

- a. Expresses an unqualified opinion.
- b. Believes it will facilitate an understanding of the reason for modification of the report.
- c. Wishes to indicate a division of responsibility.
- d. Wishes to emphasize the thoroughness of the audit.

**M84#35.** Which of the following is **not** a specialist upon whose work an auditor may rely?

- a. Actuary
- b. Appraiser
- c. Internal auditor
- d. Engineer

*Selected Questions*

**M84#36.** Of the following, which is the most efficient audit procedure for verification of interest earned on bond investments?

- a. Tracing interest declarations to an independent record book.
- b. Recomputing interest earned.
- c. Conforming interest rate with the issuer of the bonds.
- d. Vouching the receipt and deposit of interest checks.

**M84#50.** Refusal by the client's legal counsel to furnish certain requested information would most likely be considered

- a. A limitation in the scope of the auditor's examination.
- b. Indicative of the existence of material unasserted loss contingencies.
- c. A characteristic of untrustworthy management.
- d. Evidence of an inability to formulate an opinion regarding the outcome of pending litigation.

**M84#60.** The letter of inquiry that is ordinarily sent to lawyers with whom management consulted concerning litigation, claims, and assessments is the auditor's method of

- a. Identifying all possible unasserted claims.
- b. Obtaining admissions of irregularities which are safeguarded by privileged communications laws.
- c. Obtaining corroboration of information furnished by the client.
- d. Identifying impaired assets and incurred liabilities.

**N83#2.** Which of the following is **not** a typical analytical review procedure?

- a. Study of relationships of financial information with relevant nonfinancial information.
- b. Comparison of financial information with similar information regarding the industry in which the entity operates.
- c. Comparison of recorded amounts of major disbursements with appropriate invoices.
- d. Comparison of recorded amounts of major disbursements with budgeted amounts.

**N83#5.** When an auditor selects a sample of items from the vouchers payable register for the last month of the period under audit and traces these items to underlying documents, the auditor is gathering evidence primarily in support of the assertion that

- a. Recorded obligations were paid.
- b. Incurred obligations were recorded in the correct period.

- c. Recorded obligations were valid.
- d. Cash disbursements were recorded as incurred obligations.

**N83#14.** Purchase cut-off procedures should be designed to test whether or not all inventory

- a. Purchased and received before the year end was recorded.
- b. On the year end balance sheet was carried at lower of cost or market.
- c. On the year end balance sheet was paid for by the company.
- d. Owned by the company is in the possession of the company.

**N83#24.** An auditor confirms a representative number of open accounts receivable as of December 31, 1982, and investigates respondents' exceptions and comments. By this procedure the auditor would be most likely to learn of which of the following?

- a. One of the cashiers has been covering a personal embezzlement by lapping.
- b. One of the sales clerks has **not** been preparing charge slips for credit sales to family and friends.
- c. One of the EDP control clerks has been removing all sales invoices applicable to his account from the data file.
- d. The credit manager has misappropriated remittances from customers whose accounts have been written off.

**N83#25.** During the process of confirming receivables as of December 31, 1982, a positive confirmation was returned indicating the "balance owed as of December 31 was paid on January 9, 1983." The auditor would most likely

- a. Determine whether there were any changes in the account between January 1 and January 9, 1983.
- b. Determine whether a customary trade discount was taken by the customer.
- c. Reconfirm the zero balance as of January 10, 1983.
- d. Verify that the amount was received.

**N83#39.** Which of the following would **not** necessarily be a related-party transaction?

- a. Sales to another corporation with a similar name.
- b. Purchases from another corporation that is controlled by the corporation's chief stockholder.
- c. Loan from the corporation to a major stockholder.
- d. Sale of land to the corporation by the spouse of a director.

## Auditing

**M83#45.** In the examination of property, plant, and equipment, the auditor tries to determine all of the following **except** the

- a. Adequacy of internal control.
- b. Extent of property abandoned during the year.
- c. Adequacy of replacement funds.
- d. Reasonableness of the depreciation.

**M83#47.** Which of the following **best** describes the primary purpose of audit procedures?

- a. To detect errors or irregularities.
- b. To comply with generally accepted accounting principles.
- c. To gather corroborative evidence.
- d. To verify the accuracy of account balances.

**M83#51.** An auditor will ordinarily examine invoices from lawyers primarily in order to

- a. Substantiate accruals.
- b. Assess the legal ramifications of litigation in progress.
- c. Estimate the dollar amount of contingent liabilities.
- d. Identify possible unasserted litigation, claims, and assessments.

**M83#3.** The procedures specifically outlined in an audit program are primarily designed to

- a. Protect the auditor in the event of litigation.
- b. Detect errors or irregularities.
- c. Test internal systems.
- d. Gather evidence.

**M83#4.** An auditor would be most likely to consider expressing a qualified opinion or disclaimer of opinion if the client's financial statements include a footnote that

- a. Lists the amounts due from related parties including the terms and manner of settlement in routine transactions.
- b. Describes the influence which the client has over the other parties in certain transactions.
- c. Represents that certain transactions with related parties were consummated on terms equally as favorable as would have been obtained in transactions with unrelated parties.
- d. Presents the dollar volume of related party transactions and the effects of any change in the method of establishing terms from that of the prior period.

**M83#19.** Each of the following might, in itself, form a valid basis for an auditor to decide to omit a test **except** the

- a. Relative risk involved.
- b. Relationship between the cost of obtaining evidence and its usefulness.

- c. Difficulty and expense involved in testing a particular item.
- d. Degree of reliance on the relevant internal controls.

**M83#32.** An auditor reconciles the total of the accounts receivable subsidiary ledger to the general ledger control account, as of October 31, 1982. By this procedure, the auditor would be most likely to learn of which of the following?

- a. An October invoice was improperly computed.
- b. An October check from a customer was posted in error to the account of another customer with a similar name.
- c. An opening balance in a subsidiary ledger account was improperly carried forward from the previous accounting period.
- d. An account balance is past due and should be written off.

**M83#33.** An auditor has accounted for a sequence of inventory tags and is now going to trace information on a representative number of tags to the physical inventory sheets. The purpose of this procedure is to obtain assurance that

- a. The final inventory is valued at cost.
- b. All inventory represented by an inventory tag is listed on the inventory sheets.
- c. All inventory represented by an inventory tag is bona fide.
- d. Inventory sheets do **not** include untagged inventory items.

**M83#36.** The physical count of inventory of a retailer was higher than shown by the perpetual records. Which of the following could explain the difference?

- a. Inventory items had been counted but the tags placed on the items had **not** been taken off the items and added to the inventory accumulation sheets.
- b. Credit memos for several items returned by customers had **not** been recorded.
- c. No journal entry had been made on the retailer's books for several items returned to its suppliers.
- d. An item purchased "FOB shipping point" had **not** arrived at the date of the inventory count and had **not** been reflected in the perpetual records.

**M83#38.** Which of the following auditing procedures is ordinarily performed last?

- a. Reading of the minutes of the directors' meetings.
- b. Confirming accounts payable.

*Selected Questions*

- c. Obtaining a management representation letter.
- d. Testing of the purchasing function.

**M83#46.** Which of the following is ordinarily designed to detect possible material dollar errors on the financial statements?

- a. Compliance testing.
- b. Analytical review.
- c. Computer controls.
- d. Post audit working paper review.

**M83#49.** In which of the following instances would an auditor be **least** likely to require the assistance of a specialist?

- a. Assessing the valuation of inventories of art works.
- b. Determining the quantities of materials stored in piles on the ground.
- c. Determining the value of unlisted securities.
- d. Ascertaining the assessed valuation of fixed assets.

**M83#50.** A client's physical count of inventories was higher than the inventory quantities per the perpetual records. This situation could be the result of the failure to record

- a. Sales.
- b. Sales discounts.
- c. Purchases.
- d. Purchase returns.

**M83#51.** An attorney is responding to an independent auditor as a result of the audit client's letter of inquiry. The attorney may appropriately limit the response to

- a. Asserted claims and litigation.
- b. Matters to which the attorney has given substantive attention in the form of legal consultation or representation.
- c. Asserted, overtly threatened, or pending claims and litigation.
- d. Items which have an extremely high probability of being resolved to the client's detriment.

**M83#52.** In violation of company policy, Lowell Company erroneously capitalized the cost of painting its warehouse. The auditor examining Lowell's financial statements would most likely detect this when

- a. Discussing capitalization policies with Lowell's controller.
- b. Examining maintenance expense accounts.
- c. Observing, during the physical inventory observation, that the warehouse had been painted.
- d. Examining the construction work orders supporting items capitalized during the year.

**N82#6.** The letter of audit inquiry addressed to the client's legal counsel will **not** ordinarily be

- a. Sent to a lawyer who was engaged by the audit client during the year and soon thereafter resigned the engagement.
- b. A source of corroboration of the information originally obtained from management concerning litigation, claims, and assessments.
- c. Limited to references concerning only pending or threatened litigation with respect to which the lawyer has been engaged.
- d. Needed during the audit of clients whose securities are **not** registered with the SEC.

**N82#8.** As a result of analytical review procedures, the independent auditor determines that the gross profit percentage has declined from 30% in the preceding year to 20% in the current year. The auditor should

- a. Express an opinion which is qualified due to inability of the client company to continue as a going concern.
- b. Evaluate management's performance in causing this decline.
- c. Require footnote disclosure.
- d. Consider the possibility of an error in the financial statements.

**N82#10.** When an outside specialist has assumed full responsibility for taking the client's physical inventory, reliance on the specialist's report is acceptable if

- a. The auditor is satisfied through application of appropriate procedures as to the reputation and competence of the specialist.
- b. Circumstances made it impracticable or impossible for the auditor either to do the work personally or observe the work done by the inventory firm.
- c. The auditor conducted the same audit tests and procedures as would have been applicable if the client employees took the physical inventory.
- d. The auditor's report contains a reference to the assumption of full responsibility.

**N82#25.** The date of the management representation letter should coincide with the

- a. Date of the auditor's report.
- b. Balance sheet date.
- c. Date of the latest subsequent event referred to in the notes to the financial statements.
- d. Date of the engagement agreement.

**N82#28.** Audit evidence can come in different forms with different degrees of persuasiveness. Which of the following is the **least** persuasive type of evidence?

- a. Vendor's invoice.
- b. Bank statement obtained from the client.

*Auditing*

- c. Computations made by the auditor.
- d. Prenumbered client invoices.

**N82#30.** A company holds bearer bonds as a short-term investment. Responsibility for custody of these bonds and submission of coupons for periodic interest collections probably should be delegated to the

- a. Chief Accountant.
- b. Internal Auditor.
- c. Cashier.
- d. Treasurer.

**N82#31.** When obtaining evidence regarding litigation against a client, the CPA would be **least** interested in determining

- a. An estimate of when the matter will be resolved.
- b. The period in which the underlying cause of the litigation occurred.
- c. The probability of an unfavorable outcome.
- d. An estimate of the potential loss.

**N82#55.** To verify that all sales transactions have been recorded, a test of transactions should be completed on a representative sample drawn from

- a. Entries in the sales journal.
- b. The billing clerk's file of sales orders.
- c. A file of duplicate copies of sales invoices for which all prenumbered forms in the series have been accounted for.
- d. The shipping clerk's file of duplicate copies of bills of lading.

**M82#6.** Which of the following statements relating to the competence of evidential matter is always true?

- a. Evidential matter gathered by an auditor from outside an enterprise is reliable.
- b. Accounting data developed under satisfactory conditions of internal control are more relevant than data developed under unsatisfactory internal control conditions.
- c. Oral representations made by management are **not** valid evidence.
- d. Evidence gathered by auditors must be both valid and relevant to be considered competent.

**M82#10.** Which of the following is the best argument against the use of negative accounts receivable confirmations?

- a. The cost-per-response is excessively high.
- b. There is **no** way of knowing if the intended recipients received them.
- c. Recipients are likely to feel that in reality the confirmation is a subtle request for payment.
- d. The inference drawn from receiving no reply may **not** be correct.

**M82#12.** An auditor compares 1981 revenues and expenses with those of the prior year and investigates all changes exceeding 10%. By this procedure the auditor would be most likely to learn that

- a. An increase in property tax rates has **not** been recognized in the client's accrual.
- b. The 1981 provision for uncollectible accounts is inadequate, because of worsening economic conditions.
- c. Fourth quarter payroll taxes were **not** paid.
- d. The client changed its capitalization policy for small tools in 1981.

**M82#14.** Customers having substantial year-end past due balances fail to reply after second request forms have been mailed directly to them. Which of the following is the most appropriate audit procedure?

- a. Examine shipping documents.
- b. Review collections during the year being examined.
- c. Intensify the study of the client's system of internal control with respect to receivables.
- d. Increase the balance in the accounts receivable allowance (contra) account.

**M82#15.** Which of the following is the most reliable analytical review approach to verification of the year-end financial statement balances of a wholesale business?

- a. Verify depreciation expense by multiplying the depreciable asset balances by one divided by the depreciation rate.
- b. Verify commission expense by multiplying sales revenue by the company's standard commission rate.
- c. Verify interest expense, which includes imputed interest, by multiplying long term debt balances by the year-end prevailing interest rate.
- d. Verify FICA tax liability by multiplying total payroll costs by the FICA contribution rate in effect during the year.

**M82#19.** The third standard of field work states that sufficient competent evidential matter may, in part, be obtained through inspection, observation, inquiries, and confirmations to afford a reasonable basis for an opinion regarding the financial statements under examination. The evidential matter required by this standard may, in part, be obtained through

- a. Auditor working papers.
- b. Proper planning of the audit engagement.
- c. Analytical review procedures.
- d. Review of the system of internal control.

**M82#22.** When auditing contingent liabilities, which of the following procedures would be **least** effective?

- a. Reading the minutes of the board of directors.



Selected Questions

- b. Reviewing the bank confirmation letter.
- c. Examining customer confirmation replies.
- d. Examining invoices for professional services.

**M82#36.** An independent auditor finds that Simner Corporation occupies office space, at no charge, in an office building owned by a shareholder. This finding indicates the existence of

- a. Management fraud.
- b. Related party transactions.
- c. Window dressing.
- d. Weak internal control.

**M82#49.** Management's refusal to furnish a written representation on a matter which the auditor considers essential constitutes

- a. Prima facie evidence that the financial statements are **not** presented fairly.
- b. A violation of the Foreign Corrupt Practices Act.
- c. An uncertainty sufficient to preclude an unqualified opinion.
- d. A scope limitation sufficient to preclude an unqualified opinion.

**M82#58.** The controller of Excello Manufacturing, Inc., wants to use ratio analysis to identify the possible existence of idle equipment or the possibility that equipment has been disposed of without having been written off. Which of the following ratios would best accomplish this objective?

- a. Depreciation expense/book value of manufacturing equipment.
- b. Accumulated depreciation/book value of manufacturing equipment.
- c. Repairs and maintenance cost/direct labor costs.
- d. Gross manufacturing equipment cost/units produced.

**N81#2.** In the course of the examination of financial statements for the purpose of expressing an opinion thereon, the auditor will normally prepare a schedule of unadjusted differences for which the auditor did not propose adjustment when they were uncovered. What is the primary purpose served by this schedule?

- a. To point out to the responsible client officials the errors made by various company personnel.
- b. To summarize the adjustments that must be made before the company can prepare and submit its federal tax return.
- c. To identify the potential financial statement effects of errors or disputed items that were considered immaterial when discovered.
- d. To summarize the errors made by the company so that corrections can be made after the audited financial statements are released.

**N81#20.** If accounts receivable turned over 7.1 times in 1979 as compared to only 5.6 times in 1980, it is possible that there were

- a. Unrecorded credit sales in 1980.
- b. Unrecorded cash receipts in 1979.
- c. More thorough credit investigations made by the company late in 1979.
- d. Fictitious sales in 1980.

**N81#27.** In the context of an audit of financial statements, substantive tests are audit procedures that

- a. May be eliminated under certain conditions.
- b. Are designed to discover significant subsequent events.
- c. May be either tests of transactions, direct tests of financial balances, or analytical tests.
- d. Will increase proportionately with the auditor's reliance on internal control.

**N81#28.** Which of the following narrative disclosures appearing in notes to financial statements would an auditor be most likely to consider **inappropriate**?

- a. The related party transaction was consummated on terms **no** less favorable than those that would have been obtained if the transaction had been with an unrelated party.
- b. The accounts of subsidiaries in which the corporation has more than 50% ownership are fully consolidated.
- c. Legal and other costs associated with the covenant-not-to-compete will be amortized using the straight-line method during the next three years.
- d. Minor fluctuations in foreign currency exchange rates are **not** reflected in the accompanying financial statements.

**N81#34.** A representation letter issued by a client

- a. Is essential for the preparation of the audit program.
- b. Is a substitute for testing.
- c. Does **not** reduce the auditor's responsibility.
- d. Reduces the auditor's responsibility only to the extent that it is relied upon.

**N81#36.** Which of the following procedures would ordinarily be expected to best reveal unrecorded sales at the balance sheet date?

- a. Compare shipping documents with sales records.
- b. Apply gross profit rates to inventory disposed of during the period.
- c. Trace payments received subsequent to the balance sheet date.
- d. Send accounts receivable confirmation requests.

**N81#44.** In verifying the amount of goodwill recorded by a client, the most convincing evidence which an auditor can obtain is by comparing the recorded value of assets acquired with the

- a. Assessed value as evidenced by tax bills.
- b. Seller's book value as evidenced by financial statements.
- c. Insured value as evidenced by insurance policies.
- d. Appraised value as evidenced by independent appraisals.

**N81#47.** Which of the following elements ultimately determines the specific auditing procedures that are necessary in the circumstances to afford a reasonable basis for an opinion?

- a. Auditor judgment.
- b. Materiality.
- c. Relative risk.
- d. Reasonable assurance.

**N81#57.** A lawyer's response to an auditor's request for information concerning litigation, claims, and assessments will ordinarily contain which of the following?

- a. An explanation regarding limitations on the scope of the response.
- b. A statement of concurrence with the client's determination of which unasserted possible claims warrant specification.
- c. Confidential information which would be prejudicial to the client's defense if publicized.
- d. An assertion that the list of unasserted possible claims identified by the client represent all such claims of which the lawyer may be aware.

**M81#4.** Which of the following is **not** a primary objective of the auditor in the examination of accounts receivable?

- a. Determine the approximate realizable value.
- b. Determine the adequacy of internal controls.
- c. Establish validity of the receivables.
- d. Determine the approximate time of collectibility of the receivables.

**M81#10.** During an examination of a publicly-held company, the auditor should obtain written confirmation regarding debenture transactions from the

- a. Debenture holders.
- b. Client's attorney.
- c. Internal auditors.
- d. Trustee.

**M81#14.** An audit program for the examination of the retained earnings account should include a step that requires verification of the

- a. Market value used to charge retained earnings to account for a two-for-one stock split.
- b. Approval of the adjustment to the beginning balance as a result of a write-down of an account receivable.
- c. Authorization for both cash and stock dividends.
- d. Gain or loss resulting from disposition of treasury shares.

**M81#16.** The accuracy of perpetual inventory records may be established, in part, by comparing perpetual inventory records with

- a. Purchase requisitions.
- b. Receiving reports.
- c. Purchase orders.
- d. Vendor payments.

**M81#17.** The auditor should ordinarily mail confirmation requests to all banks with which the client has conducted any business during the year, regardless of the year-end balance, since

- a. The confirmation form also seeks information about indebtedness to the bank.
- b. This procedure will detect kiting activities which would otherwise not be detected.
- c. The mailing of confirmation forms to all such banks is required by generally accepted auditing standards.
- d. This procedure relieves the auditor of any responsibility with respect to nondetection of forged checks.

**M81#19.** Which of the following analyses appearing in a predecessor's working papers is the successor auditor **least** likely to be interested in reviewing?

- a. Analysis of noncurrent balance sheet accounts.
- b. Analysis of current balance sheet accounts.
- c. Analysis of contingencies.
- d. Analysis of income statement accounts.

**M81#25.** Which of the audit procedures listed below would be **least** likely to disclose the existence of related party transactions of a client during the period under audit?

- a. Reading "conflict-of-interest" statements obtained by the client from its management.
- b. Scanning accounting records for large transactions at or just prior to the end of the period under audit.
- c. Inspecting invoices from law firms.
- d. Confirming large purchase and sales transactions with the vendors and/or customers involved.

Selected Questions

**M81#26.** In which of the following instances would it be appropriate for the auditor to refer to the work of an appraiser in the auditor's report?

- a. An unqualified opinion is expressed and the auditor wishes to place emphasis on the use of a specialist.
- b. A qualified opinion is expressed because of a major uncertainty unrelated to the work of the appraiser.
- c. An adverse opinion is expressed based on a difference of opinion between the client and the outside appraiser as to the value of certain assets.
- d. A disclaimer of opinion is expressed due to a scope limitation imposed on the auditor by the appraiser.

**M81#27.** An example of a transaction which may be indicative of the existence of related parties is

- a. Borrowing or lending at a rate of interest which equals the current market rate.
- b. Selling real estate at a price that is comparable to its appraised value.
- c. Making large loans with specified terms as to when or how the funds will be repaid.
- d. Exchanging property for similar property in a nonmonetary transaction.

**M81#37.** Analytical review procedures may be classified as being primarily

- a. Compliance tests.
- b. Substantive tests.
- c. Tests of ratios.
- d. Detailed tests of balances.

**M81#43.** The auditor's program for the examination of long-term debt should include steps that require the

- a. Verification of the existence of the bondholders.
- b. Examination of any bond trust indenture.
- c. Inspection of the accounts payable subsidiary ledger.
- d. Investigation of credits to the bond interest income account.

**M81#55.** Once a CPA has determined that accounts receivable have increased due to slow collections in a "tight money" environment, the CPA would be likely to

- a. Increase the balance in the allowance for bad debts account.
- b. Review the going concern ramifications.
- c. Review the credit and collection policy.
- d. Expand tests of collectibility.

**N80#6.** When outside firms of nonaccountants specializing in the taking of physical inventories are used

to count, list, price and subsequently compute the total dollar amount of inventory on hand at the date of the physical count, the auditor will ordinarily

- a. Consider the report of the outside inventory-taking firm to be an acceptable alternative procedure to the observation of physical inventories.
- b. Make or observe some physical counts of the inventory, recompute certain inventory calculations and test certain inventory transactions.
- c. **Not** reduce the extent of work on the physical count of inventory.
- d. Consider the reduced audit effort with respect to the physical count of inventory as a scope limitation.

**N80#18.** In order to efficiently establish the correctness of the accounts payable cutoff, an auditor will be **most** likely to

- a. Coordinate cutoff tests with physical inventory observation.
- b. Compare cutoff reports with purchase orders.
- c. Compare vendors' invoices with vendors' statements.
- d. Coordinate mailing of confirmations with cutoff tests.

**N80#21.** Auditors often request that the audit client send a letter of inquiry to those attorneys who have been consulted with respect to litigation, claims, or assessments. The primary reason for this request is to provide the auditor with

- a. An estimate of the dollar amount of the probable loss.
- b. An expert opinion as to whether a loss is possible, probable or remote.
- c. Information concerning the progress of cases to date.
- d. Corroborative evidential matter.

**N80#23.** For a reporting entity that has participated in related party transactions that are material, disclosure in the financial statements should include

- a. The nature of the relationship and the terms and manner of settlement.
- b. Details of the transactions within major classifications.
- c. A statement to the effect that a transaction was consummated on terms no less favorable than those that would have been obtained if the transaction had been with an unrelated party.
- d. A reference to deficiencies in the entity's system of internal accounting control.

**N80#30.** The sequence of steps in gathering evidence as the basis of the auditor's opinion is:

## Auditing

- a. Substantive tests, internal control review and compliance tests.
- b. Internal control review, substantive tests and compliance tests.
- c. Internal control review, compliance tests and substantive tests.
- d. Compliance tests, internal control review and substantive tests.

**N80#36.** An auditor would be most likely to learn of slow-moving inventory through

- a. Inquiry of sales personnel.
- b. Inquiry of stores personnel.
- c. Physical observation of inventory.
- d. Review of perpetual inventory records.

**N80#49.** In the examination of which of the following general ledger accounts will tests of procedures be particularly appropriate?

- a. Equipment.
- b. Bonds payable.
- c. Bank charges.
- d. Sales.

**N80#50.** Which of the following analytical review procedures should be applied to the income statement?

- a. Select sales and expense items and trace amounts to related supporting documents.
- b. Ascertain that the net income amount in the statement of changes in financial position agrees with the net income amount in the income statement.
- c. Obtain from the proper client representatives the beginning and ending inventory amounts that were used to determine costs of sales.
- d. Compare the actual revenues and expenses with the corresponding figures of the previous year and investigate significant differences.

**N80#57.** In determining the adequacy of the allowance for uncollectible accounts, the **least** reliance should be placed upon which of the following?

- a. The credit manager's opinion.
- b. An aging schedule of past due accounts.
- c. Collection experience of the client's collection agency.
- d. Ratios calculated showing the past relationship of the valuation allowance to net credit sales.

**N80#58.** When title to merchandise in transit has passed to the audit client, the auditor engaged in the performance of a purchase cutoff will encounter the greatest difficulty in gaining assurance with respect to the

- a. Quantity.
- b. Quality.

- c. Price.
- d. Terms.

**M80#1.** To be competent, evidence must be both

- a. Timely and substantial.
- b. Reliable and documented.
- c. Valid and relevant.
- d. Useful and objective.

**M80#8.** Which of the following audit procedures would be **least** likely to lead the auditor to find unrecorded fixed asset disposals?

- a. Examination of insurance policies.
- b. Review of repairs and maintenance expense.
- c. Review of property tax files.
- d. Scanning of invoices for fixed asset additions.

**M80#9.** **Most** of the independent auditor's work in formulating an opinion on financial statements consists of

- a. Studying and evaluating internal control.
- b. Obtaining and examining evidential matter.
- c. Examining cash transactions.
- d. Comparing recorded accountability with assets.

**M80#11.** A CPA has received an attorney's letter in which **no** significant disagreements with the client's assessments of contingent liabilities were noted. The resignation of the client's lawyer shortly after receipt of the letter should alert the auditor that

- a. Undisclosed unasserted claims may have arisen.
- b. The attorney was unable to form a conclusion with respect to the significance of litigation, claims and assessments.
- c. The auditor must begin a completely new examination of contingent liabilities.
- d. An adverse opinion will be necessary.

**M80#15.** An auditor will usually trace the details of the test counts made during the observation of the physical inventory taking to a final inventory schedule. This audit procedure is undertaken to provide evidence that items physically present and observed by the auditor at the time of the physical inventory count are

- a. Owned by the client.
- b. **Not** obsolete.
- c. Physically present at the time of the preparation of the final inventory schedule.
- d. Included in the final inventory schedule.

**M80#29.** Johnson is engaged in the audit of a utility which supplies power to a residential community. All accounts receivable balances are small and internal control is effective. Customers are billed bi-monthly. In

## Selected Questions

order to determine the validity of the accounts receivable balances at the balance sheet date, Johnson would most likely

- Examine evidence of subsequent cash receipts instead of sending confirmation requests.
- Send positive confirmation requests.
- Send negative confirmation requests.
- Use statistical sampling instead of sending confirmation requests.

**M80#30.** The auditor may conclude that depreciation charges are insufficient by noting

- Insured values greatly in excess of book values.
- Large amounts of fully depreciated assets.
- Continuous trade-ins of relatively new assets.
- Excessive recurring losses on assets retired.

**M80#37.** How does the extent of substantive tests required to constitute sufficient evidential matter vary with the auditor's reliance on internal control?

- Randomly.
- Disproportionately.
- Directly.
- Inversely.

**M80#45.** When an examination is made in accordance with generally accepted auditing standards, the independent auditor must

- Utilize statistical sampling.
- Employ analytical review procedures.
- Obtain certain written representations from management.
- Observe the taking of physical inventory on the balance sheet date.

**M80#49.** In verifying debits to perpetual inventory records of a non-manufacturing firm, the auditor would be **most** interested in examining the purchase

- Journal.
- Requisitions.
- Orders.
- Invoices.

### B. Specific Audit Objectives and Procedures

**N84#23.** An auditor usually examines receiving reports to support entries in the

- Voucher register and sales returns journal.
- Sales journal and sales returns journal.
- Voucher register and sales journal.
- Check register and sales journal.

**N84#27.** An auditor would be **least** likely to use confirmations in connection with the examination of

- Inventories.
- Refundable income taxes.

- Long-term debt.
- Stockholders' equity.

**N84#28.** An auditor would be most likely to identify a contingent liability by mailing a(an)

- Standard bank confirmation.
- Related party transaction confirmation.
- Accounts payable confirmation.
- Transfer agent confirmation.

**N84#31.** To test for unsupported entries in the ledger, the direction of audit testing should be from the

- Journal entries.
- Ledger entries.
- Original source documents.
- Externally generated documents.

**N84#47.** The auditor will most likely perform extensive tests for possible understatement of

- Revenues.
- Assets.
- Liabilities.
- Capital.

**M84#12.** As one of the year-end audit procedures, the auditor instructed the client's personnel to prepare a standard bank confirmation request for a bank account that had been closed during the year. After the client's treasurer had signed the request, it was mailed by the assistant treasurer. What is the major flaw in this audit procedure?

- The confirmation request was signed by the treasurer.
- Sending the request was meaningless because the account was closed before the year-end.
- The request was mailed by the assistant treasurer.
- The CPA did **not** sign the confirmation request before it was mailed.

**M84#49.** An unrecorded check issued during the last week of the year would most likely be discovered by the auditor when the

- Check register for the last month is reviewed.
- Cut-off bank statement is reconciled.
- Bank confirmation is reviewed.
- Search for unrecorded liabilities is performed.

**M83#12.** Tracing copies of sales invoices to shipping documents will provide evidence that all

- Shipments to customers were recorded as receivables.
- Billed sales were shipped.
- Debits to the subsidiary accounts receivable ledger are for sales shipped.
- Shipments to customers were billed.

## Auditing

**N83#42.** For which of the following ledger accounts would the auditor be **most** likely to analyze the details?

- Service Revenue.
- Sales.
- Repairs and maintenance expense.
- Sales salaries expense.

**N82#12.** Which of the following factors will **least** affect the independent auditor's judgment as to the quantity, type, and content of working papers desirable for a particular engagement?

- Nature of the auditor's report.
- Nature of the financial statements, schedules, or other information upon which the auditor is reporting.
- Need for supervision and review.
- Number of personnel assigned to the audit.

**N82#13.** An auditor's working papers will generally be **least** likely to include documentation showing how the

- Client's schedules were prepared.
- Engagement had been planned.
- Client's system of internal control had been reviewed and evaluated.
- Unusual matters were resolved.

**N82#16.** Which of the following procedures relating to the examination of accounts payable could the auditor delegate entirely to the client's employees?

- Test footings in the accounts payable ledger.
- Reconcile unpaid invoices to vendors' statements.
- Prepare a schedule of accounts payable.
- Mail confirmations for selected account balances.

**N82#18.** Which of the following audit procedures is **least** likely to detect an unrecorded liability?

- Analysis and recomputation of interest expense.
- Analysis and recomputation of depreciation expense.
- Mailing of standard bank confirmation form.
- Reading of the minutes of meetings of the board of directors.

**N82#52.** An auditor compares information on cancelled checks with information contained in the cash disbursement journal. The objective of this test is to determine that

- Recorded cash disbursement transactions are properly authorized.
- Proper cash purchase discounts have been recorded.

c. Cash disbursements are for goods and services actually received.

d. **No** discrepancies exist between the data on the checks and the data in the journal.

**N82#56.** Ajax, Inc., is an affiliate of the audit client and is audited by another firm of auditors. Which of the following is **most** likely to be used by the auditor to obtain assurance that all guarantees of the affiliate's indebtedness have been detected?

- Send the standard bank confirmation request to all of the client's lender banks.
- Review client minutes and obtain a representation letter.
- Examine supporting documents for all entries in intercompany accounts.
- Obtain written confirmation of indebtedness from the auditor of the affiliate.

**N82#40.** An examination of the balance in the accounts payable account is ordinarily **not** designed to

- Detect accounts payable which are substantially past due.
- Verify that accounts payable were properly authorized.
- Ascertain the reasonableness of recorded liabilities.
- Determine that all existing liabilities at the balance sheet date have been recorded.

**N81#21.** Under which of the following circumstances would an auditor be most likely to intensify an examination of a \$500 imprest petty cash fund?

- Reimbursement vouchers are **not** prenumbered.
- Reimbursement occurs twice each week.
- The custodian occasionally uses the cash fund to cash employee checks.
- The custodian endorses reimbursement checks.

**N81#22.** Which of the following is the **least** persuasive documentation in support of an auditor's opinion?

- Schedules of details of physical inventory counts conducted by the client.
- Notation of inferences drawn from ratios and trends.
- Notation of appraisers' conclusions documented in the auditor's working papers.
- Lists of negative confirmation requests for which **no** response was received by the auditor.

**N81#37.** Which of the following is **not** a primary purpose of audit working papers?

- To coordinate the examination.
- To assist in preparation of the audit report.

*Selected Questions*

- c. To support the financial statements.
- d. To provide evidence of the audit work performed.

**N81#40.** Which of the following is one of the better auditing techniques that might be used by an auditor to detect kiting?

- a. Review composition of authenticated deposit slips.
- b. Review subsequent bank statements and cancelled checks received directly from the banks.
- c. Prepare a schedule of bank transfers from the client's books.
- d. Prepare year-end bank reconciliations.

**N81#46.** A cash shortage may be concealed by transporting funds from one location to another or by converting negotiable assets to cash. Because of this, which of the following is vital?

- a. Simultaneous confirmations.
- b. Simultaneous bank reconciliations.
- c. Simultaneous verification.
- d. Simultaneous surprise cash count.

**N81#48.** The negative form of accounts receivable confirmation request is particularly useful **except** when

- a. Internal control surrounding accounts receivable is considered to be effective.
- b. A large number of small balances are involved.
- c. The auditor has reason to believe the persons receiving the requests are likely to give them consideration.
- d. Individual account balances are relatively large.

**N81#49.** An auditor who is engaged to examine the financial statements of a business enterprise will request a cutoff bank statement primarily in order to

- a. Verify the cash balance reported on the bank confirmation inquiry form.
- b. Verify reconciling items on the client's bank reconciliation.
- c. Detect lapping.
- d. Detect kiting.

**M81#39.** A CPA examines a sample of copies of December and January sales invoices for the initials of the person who verified the quantitative data. This is an example of a

- a. Compliance test.
- b. Substantive test.
- c. Cutoff test.
- d. Statistical test.

**M81#40.** Patentex developed a new secret formula which is of great value because it resulted in a virtual monopoly. Patentex has capitalized all research and development costs associated with this formula. Greene, CPA, who is examining this account, will probably

- a. Confer with management regarding transfer of the amount from the balance sheet to the income statement.
- b. Confirm that the secret formula is registered and on file with the county clerk's office.
- c. Confer with management regarding a change in the title of the account to "goodwill."
- d. Confer with management regarding ownership of the secret formula.

**M81#45.** Which of the following explanations might satisfy an auditor who discovers significant debits to an accumulated depreciation account?

- a. Extraordinary repairs have lengthened the life of an asset.
- b. Prior years' depreciation charges were erroneously understated.
- c. A reserve for possible loss on retirement has been recorded.
- d. An asset has been recorded at its fair value.

**N80#7.** All corporate capital stock transactions should ultimately be traced to the

- a. Minutes of the board of directors.
- b. Cash receipts journal.
- c. Cash disbursements journal.
- d. Numbered stock certificates.

**N80#20.** When using a statistical sampling plan, the auditor would probably require a smaller sample if the

- a. Population increases.
- b. Desired precision interval narrows.
- c. Desired reliability decreases.
- d. Expected error occurrence rate increases.

**N80#29.** An auditor would be **least** likely to use confirmations in connection with the examination of

- a. Inventories.
- b. Long-term debt.
- c. Property, plant, and equipment.
- d. Stockholders' equity.

**N80#31.** The auditor's count of the client's cash should be coordinated to coincide with the

- a. Study of the system of internal controls with respect to cash.
- b. Close of business on the balance sheet date.
- c. Count of marketable securities.
- d. Count of inventories.

*Auditing*

**N80#34.** Which of the following procedures is **least** likely to be performed before the balance sheet date?

- a. Observation of inventory.
- b. Review of internal control over cash disbursements.
- c. Search for unrecorded liabilities.
- d. Confirmation of receivables.

**N80#38.** Which of the following is **not** one of the auditor's primary objectives in an examination of marketable securities?

- a. To determine whether securities are authentic.
- b. To determine whether securities are the property of the client.
- c. To determine whether securities actually exist.
- d. To determine whether securities are properly classified on the balance sheet.

**N80#42.** Several years ago, Conway, Inc. secured a conventional real estate mortgage loan. Which of the following audit procedures would be **least** likely to be performed by an auditor examining the mortgage balance?

- a. Examine the current year's cancelled checks.
- b. Review the mortgage amortization schedule.
- c. Inspect public records of lien balances.
- d. Recompute mortgage interest expense.

**N80#46.** Which of the following eliminates voluminous details from the auditor's working trial balance by classifying and summarizing similar or related items?

- a. Account analyses.
- b. Supporting schedules.
- c. Control accounts.
- d. Lead schedules.

**N80#51.** Which of the following is the **best** audit procedure for determining the existence of unrecorded liabilities?

- a. Examine confirmation requests returned by creditors whose accounts appear on a subsidiary trial balance of accounts payable.
- b. Examine unusual relationships between monthly accounts payable balances and recorded purchases.
- c. Examine a sample of invoices a few days prior to and subsequent to year end to ascertain whether they have been properly recorded.
- d. Examine a sample of cash disbursements in the period subsequent to year end.

**N80#54.** When examining a client's statement of changes in financial position, for audit evidence, an auditor will rely primarily upon

- a. Determination of the amount of working capital at year end.

- b. Cross-referencing to balances and transactions reviewed in connection with the examination of the other financial statements.
- c. Analysis of significant ratios of prior years as compared to the current year.
- d. The guidance provided by the APB Opinion on the statement of changes in financial position.

**N80#60.** A corporate balance sheet indicates that one of the corporate assets is a patent. An auditor will **most** likely obtain evidence regarding the continuing validity and existence of this patent by obtaining a written representation from

- a. A patent attorney.
- b. A regional State Patent Office.
- c. The patent inventor.
- d. The patent owner.

**M80#4.** During the first part of the current fiscal year, the client company began dealing with certain customers on a consignment basis. Which of the following audit procedures is **least** likely to bring this new fact to the auditor's attention?

- a. Tracing of shipping documents to the sales journal.
- b. Test of cash receipts transactions.
- c. Confirmation of accounts receivable.
- d. Observation of physical inventory.

**M80#12.** In the audit of a medium-sized manufacturing concern, which one of the following areas would be expected to require the **least** amount of audit time?

- a. Owners' equity.
- b. Revenue.
- c. Assets.
- d. Liabilities.

**M80#28.** Treetop Corporation acquired a building and arranged mortgage financing during the year. Verification of the related mortgage acquisition costs would be **least** likely to include an examination of the related

- a. Deed.
- b. Cancelled checks.
- c. Closing statement.
- d. Interest expense.

**M80#31.** The auditor is **least** likely to learn of retirements of equipment through which of the following?

- a. Review of the purchase return and allowance account.
- b. Review of depreciation.
- c. Analysis of the debits to the accumulated depreciation account.
- d. Review of insurance policy riders.



*Selected Questions*

**M80#34.** The auditor is concerned with establishing that dividends are paid to stockholders of the client corporation owning stock as of the

- a. Issue date.
- b. Declaration date.
- c. Record date.
- d. Payment date.

**M80#35.** Which of the following is the **most** efficient audit procedure for the detection of unrecorded liabilities at the balance sheet date?

- a. Confirm large accounts payable balances at the balance sheet date.
- b. Compare cash disbursements in the subsequent period with the accounts payable trial balance at year end.
- c. Examine purchase orders issued for several days prior to the close of the year.
- d. Obtain an attorney's letter from the client's attorney.

**M80#40.** To check the accuracy of hours worked, an auditor would ordinarily compare clock cards with

- a. Personnel records.
- b. Shop job time tickets.
- c. Labor variance reports.
- d. Time recorded in the payroll register.

**M80#44.** Once satisfied that the balance sheet and income statement are fairly presented in accordance with generally accepted accounting principles, an auditor who is examining the statement of changes in financial position would be most concerned with details of transactions in

- a. Cash.
- b. Trade receivables.
- c. Notes payable.
- d. Dividends payable.

**M80#52.** Auditor confirmation of accounts payable balances at the balance sheet date may be **unnecessary** because

- a. This is a duplication of cutoff tests.
- b. Accounts payable balances at the balance sheet date may **not** be paid before the audit is completed.
- c. Correspondence with the audit client's attorney will reveal all legal action by vendors for nonpayment.
- d. There is likely to be other reliable external evidence available to support the balances.

**M80#57.** The primary difference between an audit of the balance sheet and an audit of the income statement lies in the fact that the audit of the income statement deals with the verification of

- a. Transactions.
- b. Authorizations.

- c. Costs.
- d. Cutoffs.

**C. Other Specific Topics**

**N84#11.** Which of the following methods of testing application controls utilizes a generalized audit software package prepared by the auditors?

- a. Parallel simulation.
- b. Integrated testing facility approach.
- c. Test data approach.
- d. Exception report tests.

**N84#13.** Which of the following models expresses the general relationship of risks associated with the auditor's evaluation of internal accounting controls (IC), analytical review procedures and other relevant substantive tests (AR), and ultimate audit risk (UR), that would lead the auditor to conclude that additional substantive tests of details of an account balance are **not** necessary?

	<u>AR</u>	<u>IC</u>	<u>UR</u>
a.	20%	40%	10%
b.	20%	60%	5%
c.	10%	70%	4½%
d.	30%	40%	5½%

**N84#14.** Using statistical sampling to assist in verifying the year-end accounts payable balance, an auditor has accumulated the following data:

	<u>Number of accounts</u>	<u>Book balance</u>	<u>Balance determined by the auditor</u>
Population	4,100	\$5,000,000	?
Sample	200	\$ 250,000	\$300,000

Using the ratio estimation technique, the auditor's estimate of year-end accounts payable balance would be

- a. \$6,150,000
- b. \$6,000,000
- c. \$5,125,000
- d. \$5,050,000

**N84#19.** Which of the following is **not** among the errors that an auditor might include in the test data when auditing a client's EDP system?

- a. Numeric characters in alphanumeric fields.
- b. Authorization code.
- c. Differences in description of units of measure.
- d. Illogical entries in fields whose logic is tested by programmed consistency checks.

**N84#29.** In auditing through a computer, the test data method is used by auditors to test the

- a. Accuracy of input data.

*Auditing*

- b. Validity of the output.
- c. Procedures contained within the program.
- d. Normalcy of distribution of test data.

**M84#38.** Which of the following subsequent events will be **least** likely to result in an adjustment to the financial statements?

- a. Culmination of events affecting the realization of accounts receivable owned as of the balance sheet date.
- b. Culmination of events affecting the realization of inventories owned as of the balance sheet date.
- c. Material changes in the settlement of liabilities which were estimated as of the balance sheet date.
- d. Material changes in the quoted market prices of listed investment securities since the balance sheet date.

**M84#7.** Statistical sampling provides a technique for

- a. Exactly defining materiality.
- b. Greatly reducing the amount of substantive testing.
- c. Eliminating judgment in testing.
- d. Measuring the sufficiency of evidential matter.

**M84#21.** The theoretical distribution of means from all possible samples of a given size is a normal distribution and this distribution is the basis for statistical sampling. Which of the following statements is **not** true with respect to the sampling distribution of sample means?

- a. Approximately 68% of the sample means will be within one standard deviation of the mean for the normal distribution.
- b. The distribution is defined in terms of its mean and its standard error of the mean.
- c. An auditor can be approximately 95% confident that the mean for a sample is within two standard deviations of the population mean.
- d. The items drawn in an auditor's sample will have a normal distribution.

**M84#30.** In examining cash disbursements, an auditor plans to choose a sample using systematic selection with a random start. The primary advantage of such a systematic selection is that population items

- a. Which include irregularities will **not** be overlooked when the auditor exercises compatible reciprocal options.
- b. May occur in a systematic pattern, thus making the sample more representative.
- c. May occur more than once in a sample.
- d. Do **not** have to be prenumbered in order for the auditor to use the technique.

**M84#46.** Which of the following material events occurring subsequent to the December 31, 1983, balance sheet would **not** ordinarily result in an adjustment to the financial statements before they are issued on March 2, 1984?

- a. Write-off of a receivable from a debtor who had suffered from deteriorating financial condition for the past 6 years. The debtor filed for bankruptcy on January 23, 1984.
- b. Acquisition of a subsidiary on January 23, 1984. Negotiations had begun in December of 1983.
- c. Settlement of extended litigation on January 23, 1984, in excess of the recorded year-end liability.
- d. A 3 for 5 reverse stock split consummated on January 23, 1984.

**M83#13.** In the application of statistical techniques to the estimation of dollar amounts, a preliminary sample is usually taken primarily for the purpose of estimating the population

- a. Variability.
- b. Mode.
- c. Range.
- d. Median.

**M83#1.** In which of the following cases would the auditor be most likely to conclude that all of the items in an account under consideration should be examined rather than tested on a sample basis?

	<u>The measure of tolerable error is</u>	<u>Error frequency is expected to be</u>
a.	Large	Low
b.	Small	High
c.	Large	High
d.	Small	Low

**M83#53.** Governmental auditing often extends beyond examinations leading to the expression of opinion on the fairness of financial presentation and includes audits of efficiency, effectiveness, and

- a. Internal control.
- b. Evaluation.
- c. Accuracy.
- d. Compliance.

**M82#40.** Which of the following is true of generalized audit software packages?

- a. They can be used only in auditing on-line computer systems.
- b. They can be used on any computer without modification.
- c. They each have their own characteristics which the auditor must carefully consider before using in a given audit situation.
- d. They enable the auditor to perform all manual compliance test procedures less expensively.

Selected Questions

**N82#44.** A typical objective of an operational audit is for the auditor to

- Determine whether the financial statements fairly present the entity's operations.
- Evaluate the feasibility of attaining the entity's operational objectives.
- Make recommendations for improving performance.
- Report on the entity's relative success in attaining profit maximization.

**M82#17.** A major customer of an audit client suffers a fire just prior to completion of year-end fieldwork. The audit client believes that this event could have a significant direct effect on the financial statements. The auditor should

- Advise management to disclose the event in notes to the financial statements.
- Disclose the event in the auditor's report.
- Withhold submission of the auditor's report until the extent of the direct effect on the financial statements is known.
- Advise management to adjust the financial statements.

**M82#27.** More than one file may be stored on a single magnetic memory disc. Several programs may be in the core storage unit simultaneously. In both cases it is important to prevent the mixing of data. One way to do this is to use

- File integrity control.
- Boundary protection.
- Interleaving.
- Paging.

**M82#53.** In a computerized system, procedure or problem-oriented language is converted to machine language through a (an)

- Interpreter.
- Verifier.
- Compiler.
- Converter.

**N81#12.** Which of the following statistical selection techniques is **least** desirable for use by an auditor?

- Systematic selection.
- Stratified selection.
- Block selection.
- Sequential selection.

**N81#25.** An accounts receivable aging schedule was prepared on 300 pages with each page containing the aging data for 50 accounts. The pages were numbered from 1 to 300 and the accounts listed on each were numbered from 1 to 50.

Godla, an auditor, selected accounts receivable for confirmation using a table of numbers as illustrated:

Procedures performed by Godla

Select column from table of numbers	Separate 5 digits: First 3 digits Last 2 digits
02011	020—11 x
85393	853—93 *
97265	972—65 *
61680	616—80 *
16656	166—56 *
42751	427—51 *
69994	699—94 *
07942	079—42 y
10231	102—31 z
53988	539—88 *

- x Mailed confirmation to account 11 listed on page 20  
y Mailed confirmation to account 42 listed on page 79  
z Mailed confirmation to account 31 listed on page 102  
\* Rejected

This is an example of which of the following sampling methods?

- Acceptance sampling.
- Systematic sampling.
- Sequential sampling.
- Random sampling.

**N81#38.** Auditors often make use of computer programs that perform routine processing functions such as sorting and merging. These programs are made available by electronic data processing companies and others and are specifically referred to as

- Compiler programs.
- Supervisory programs.
- Utility programs.
- User programs.

**N81#52.** "Subsequent events" for reporting purposes are defined as events which occur subsequent to the

- Balance sheet date.
- Date of the auditor's report.
- Balance sheet date but prior to the date of the auditor's report.
- Date of the auditor's report and concern contingencies which are not reflected in the financial statements.

**M81#11.** An advantage of using statistical sampling techniques is that such techniques

- Mathematically measure risk.
- Eliminate the need for judgmental decisions.
- Define the values of precision and reliability required to provide audit satisfaction.
- Have been established in the courts to be superior to judgmental sampling.

## Auditing

**M81#18.** In estimation sampling for attributes, which one of the following must be known in order to appraise the results of the auditor's sample?

- a. Estimated dollar value of the population.
- b. Standard deviation of the values in the population.
- c. Actual occurrence rate of the attribute in the population.
- d. Sample size.

**M81#21.** Assume that an auditor estimates that 10,000 checks were issued during the accounting period. If an EDP application control which performs a limit check for each check request is to be subjected to the auditor's test-data approach, the sample should include

- a. Approximately 1,000 test items.
- b. A number of test items determined by the auditor to be sufficient under the circumstances.
- c. A number of test items determined by the auditor's reference to the appropriate sampling tables.
- d. One transaction.

**N80#16.** Under which of the following circumstances may audited financial statements contain a note disclosing a subsequent event which is labeled unaudited?

- a. When the subsequent event does **not** require adjustment of the financial statements.
- b. When the event occurs after completion of fieldwork and before issuance of the auditor's report.
- c. When audit procedures with respect to the subsequent event were **not** performed by the auditor.
- d. When the event occurs between the date of the auditor's original report and the date of the reissuance of the report.

**N80#25.** An auditor will use the EDP test data method in order to gain certain assurances with respect to the

- a. Input data.
- b. Machine capacity.
- c. Procedures contained within the program.
- d. Degree of keypunching accuracy.

**N80#41.** Use of the ratio estimation sampling technique to estimate dollar amounts is **inappropriate** when

- a. The total book value is known and corresponds to the sum of all the individual book values.

- b. A book value for each sample item is unknown.
- c. There are some observed differences between audited values and book values.
- d. The audited values are nearly proportional to the book values.

**M80#5.** If certain forms are **not** consecutively numbered

- a. Selection of a random sample probably is **not** possible.
- b. Systematic sampling may be appropriate.
- c. Stratified sampling should be used.
- d. Random number tables can **not** be used.

**M80#17.** The client's EDP exception reporting system helps an auditor to conduct a more efficient audit because it

- a. Condenses data significantly.
- b. Highlights abnormal conditions.
- c. Decreases the EDP compliance testing.
- d. Is an efficient EDP input control.

**M80#18.** Which of the following is an advantage of generalized computer audit packages?

- a. They are all written in one identical computer language.
- b. They can be used for audits of clients that use differing EDP equipment and file formats.
- c. They have reduced the need for the auditor to study input controls for EDP-related procedures.
- d. Their use can be substituted for a relatively large part of the required compliance testing.

**M80#21.** In a daily computer run to update checking account balances and print out basic details on any customer's account that was overdrawn, the overdrawn account of the computer programmer was never printed. Which of the following control procedures would have been **most** effective in detecting this irregularity?

- a. Use of the test-deck approach by the auditor in testing the client's program and verification of the subsidiary file.
- b. Use of a running control total for the master file of checking account balances and comparison with the printout.
- c. A program check for valid customer code.
- d. Periodic recompiling of programs from documented source decks, and comparison with programs currently in use.

## Selected Questions

**N80#60.** Operational audits generally have been conducted by internal auditors and governmental audit agencies but may be performed by certified public accountants. A primary purpose of an operational audit is to provide

- a. A means of assurance that internal accounting controls are functioning as planned.

- b. Aid to the independent auditor, who is conducting the examination of the financial statements.
- c. The results of internal examinations of financial and accounting matters to a company's top-level management.
- d. A measure of management performance in meeting organizational goals.

## IV. Reporting

### A. Reporting Standards and Types of Reports

**N84#5.** The statement that "nothing came to our attention which would indicate that these statements are not fairly presented" expresses which of the following?

- a. Disclaimer of an opinion.
- b. Negative assurance.
- c. Negative confirmation.
- d. Piecemeal opinion.

**N84#8.** The objective of a review of interim financial information is to provide the CPA with a basis for

- a. Expressing a limited opinion that the financial information is presented in conformity with generally accepted accounting principles.
- b. Expressing a compilation opinion on the financial information.
- c. Reporting whether material modifications should be made to such information to make it conform with generally accepted accounting principles.
- d. Reporting limited assurance to the board of directors only.

**N84#22.** If the auditor obtains satisfaction with respect to the accounts receivable balance by alternative procedures because it is impracticable to confirm accounts receivable, the auditor's report should be unqualified and could be expected to

- a. Disclose that alternative procedures were used due to a client-imposed scope limitation.
- b. Disclose that confirmation of accounts receivable was impracticable in the opinion paragraph.
- c. Not mention the alternative procedures.
- d. Refer to a footnote that discloses the alternative procedures.

**N84#25.** Which of the following portions of a continuing auditor's opinion paragraph on comparative financial statements is **incorrect**?

- a. In our opinion, the financial statements referred to above present fairly the financial position. . . .

- b. Of XYZ Company as of December 31, 1980 and 1979, and the results of its operations and the changes in its financial position . . . .
- c. For the years then ended, in conformity with generally accepted accounting principles . . . .
- d. Applied on a basis consistent with that of the preceding year.

**N84#41.** The fourth reporting standard requires the auditor's report to contain either an expression of opinion regarding the financial statements taken as a whole, or an assertion to the effect that an opinion cannot be expressed. The objective of the fourth standard is to prevent

- a. An auditor from reporting on one basic financial statement and **not** the others.
- b. An auditor from expressing different opinions on each of the basic financial statements.
- c. Management from reducing its final responsibility for the basic financial statements.
- d. Misinterpretations regarding the degree of responsibility the auditor is assuming.

**N84#50.** An auditor's opinion reads as follows: "In our opinion, except for the above-mentioned limitation on the scope of our examination. . ." This is an example of a(an)

- a. Review opinion.
- b. Emphasis of a matter.
- c. Qualified opinion.
- d. Unacceptable reporting practice.

**N84#51.** When a client will **not** make essential corporate minutes available to the auditor, the audit report will probably contain a(an)

- a. Unqualified opinion.
- b. Adverse opinion.
- c. Qualified opinion.
- d. Disclaimer of opinion.

**N84#52.** Auditors' reports issued in connection with which of the following are generally **not** considered to be special reports or special purpose reports?

- a. Specified elements, accounts, or items of a financial statement.

## Auditing

- b. Compliance with aspects of contractual agreements related to audited financial statements.
- c. Financial statements prepared in conformity with the price-level basis of accounting.
- d. Compiled financial statements prepared in accordance with appraised liquidation values.

**N84#53.** An auditor's report includes a statement that, "the financial statements do not present fairly the financial position, results of operations or changes in financial position in conformity with generally accepted accounting principles." This auditor's report was probably issued in connection with financial statements that were

- a. Prepared on a comprehensive basis of accounting other than generally accepted accounting principles.
- b. Restricted for use by management.
- c. Misleading.
- d. Condensed.

**N84#58.** The auditor who wishes to point out that the entity has significant transactions with related parties should disclose this fact in

- a. An explanatory paragraph to the auditor's report.
- b. An explanatory footnote to the financial statements.
- c. The body of the financial statements.
- d. The "Summary of significant accounting policies" section of the financial statements.

**M84#3.** When the audited financial statements of the prior year are presented together with those of the current year, the continuing auditor's report should cover

- a. Both years.
- b. Only the current year.
- c. Only the current year, but the prior year's report should be presented.
- d. Only the current year, but the prior year's report should be referred to.

**M84#4.** An auditor's report on financial statements that are prepared in accordance with a comprehensive basis of accounting other than generally accepted accounting principles should preferably include all of the following, **except**

- a. Disclosure of the fact that the financial statements are **not** intended to be presented in conformity with generally accepted accounting principles.
- b. An opinion as to whether the use of the disclosed method is appropriate.
- c. An opinion as to whether the financial statements are presented fairly in conformity with the basis of accounting described.
- d. An opinion as to whether the disclosed basis of accounting has been applied in a manner consistent with the preceding period.

**M84#9.** Each page of the financial statements compiled by an accountant should include a reference such as

- a. See accompanying accountant's footnotes.
- b. Unaudited, see accountant's disclaimer.
- c. See accountant's compilation report.
- d. Subject to compilation restrictions.

**M84#17.** During a review of financial statements of a non-public entity, the CPA would be **least** likely to

- a. Perform analytical procedures designed to identify relationships that appear to be unusual.
- b. Obtain written confirmation from management regarding loans to officers.
- c. Obtain reports from other accountants who reviewed a portion of the total entity.
- d. Read the financial statements and consider conformance with generally accepted accounting principles.

**M84#18.** If the auditor believes there is minimal likelihood that resolution of an uncertainty will have a material effect on the financial statements, the auditor would issue a(an)

- a. "Except for" opinion.
- b. Adverse opinion.
- c. Unqualified opinion.
- d. "Subject to" opinion.

**M84#39.** The predecessor auditor, who is satisfied after properly communicating with the successor auditor, has reissued a report because the audit client desires comparative financial statements. The predecessor auditor's report should make

- a. No reference to the report or the work of the successor auditor.
- b. Reference to the work of the successor auditor in the scope and opinion paragraphs.
- c. Reference to both the work and the report of the successor auditor only in the opinion paragraph.
- d. Reference to the report of the successor auditor only in the scope paragraph.

**M84#43.** When, in the auditor's judgment, the financial statements are **not** presented fairly in conformity with generally accepted accounting principles, the auditor will issue a(an)

- a. Qualified opinion.
- b. Special report.
- c. Disclaimer of opinion.
- d. Adverse opinion.

**M84#45.** An auditor's examination reveals a misstatement in segment information that is material in relation to the financial statements taken as a whole. If the client refuses to make modifications to the presentation of segment information the auditor should issue a(an)

- a. "Except for" opinion.

## Selected Questions

- b. "Subject to" opinion.
- c. Unqualified opinion.
- d. Disclaimer of opinion.

**M84#52.** If an accounting change has **no** material effect on the financial statements in the current year, but the change is reasonably certain to have a material effect in later years, the change should be

- a. Treated as a consistency modification in the auditor's report for the current year.
- b. Disclosed in the notes to the financial statements of the current year.
- c. Disclosed in the notes to the financial statements and referred to in the auditor's report for the current year.
- d. Treated as a subsequent event.

**M84#53.** An auditor's report included an additional paragraph disclosing that there is a difference of opinion between the auditor and the client for which the auditor believed an adjustment to the financial statements should be made. The opinion paragraph of the auditor's report most likely expressed a(an)

- a. Unqualified opinion.
- b. "Except for" opinion.
- c. "Subject to" opinion.
- d. Disclaimer of opinion.

**M84#57.** When comparative financial statements are presented, the fourth standard of reporting, which refers to financial statements "taken as a whole," should be considered to apply to the financial statement of the

- a. Periods presented plus one preceding period.
- b. Current period only.
- c. Current period and those of the other periods presented.
- d. Current and immediately preceding period only.

**M84#59.** An auditor's standard report expressed an unqualified opinion and includes a middle paragraph that emphasizes a matter included in the notes to the financial statements. The auditor's report would be deficient if the middle paragraph states that the entity

- a. Is a component of a larger business enterprise.
- b. Has changed from the completed-contract method to the percentage-of-completion method for accounting for long-term construction contracts.
- c. Has had a significant subsequent event.
- d. Has accounting reclassifications that enhance the comparability between years.

**N83#1.** Which one of the following would require a consistency modification in the auditor's report?

- a. Changing the salvage value of an asset.
- b. Changing the presentation of prepaid insurance from inclusion in "other assets" to disclosing it as a separate line item.

- c. Division of the consolidated subsidiary into two subsidiaries which are both consolidated.
- d. Changing from consolidating a wholly-owned subsidiary to carrying it on the equity basis.

**N83#16.** The first standard of reporting requires that, "the report shall state whether the financial statements are presented in accordance with generally accepted accounting principles." This should be construed to require

- a. A statement of fact by the auditor.
- b. An opinion by the auditor.
- c. An implied measure of fairness.
- d. An objective measure of compliance.

**N83#17.** An auditor refers to significant related party transactions in a middle paragraph of the report. If the ensuing opinion paragraph contains the words, "with the foregoing explanation," the auditor's report would be considered a(n)

- a. Unqualified opinion with appropriate reference to the middle paragraph.
- b. Example of inappropriate reporting.
- c. Adverse opinion.
- d. Negative assurance opinion.

**N83#18.** If management refuses to furnish certain written representations that the auditor believes are essential, which of the following is appropriate?

- a. The auditor can rely on oral evidence relating to the matter as a basis for an unqualified opinion.
- b. The client's refusal does **not** constitute a scope limitation that may lead to a modification of the opinion.
- c. This may have an effect on the auditor's ability to rely on other representations of management.
- d. The auditor should issue an adverse opinion because of management's refusal.

**N83#26.** Raider, Inc. uses the last-in, first-out method of valuation for half of its inventory and the first-in, first-out method of valuation for the other half of its inventory. Assuming the auditor is satisfied in all other respects, under these circumstances the auditor will issue a(n)

- a. Opinion modified due to inconsistency.
- b. Unqualified opinion with an explanatory middle paragraph.
- c. Qualified or adverse opinion depending upon materiality.
- d. Unqualified opinion.

**N83#28.** Apex Incorporated issued common stock to acquire another company, in an acquisition that was accounted for as a pooling of interests. The auditor examining this transaction would be **least** interested in ascertaining

- a. The net book value of the acquired company.

- b. The par value of the stock that was issued.
- c. Whether or **not** the acquisition was approved by the board of directors of Apex Incorporated.
- d. Whether the fair market value of the acquired assets were independently appraised.

**N83#30.** During a review of the financial statements of a nonpublic entity, the CPA finds that the financial statements contain a material departure from generally accepted accounting principles. If management refuses to correct the financial statement presentations, the CPA should

- a. Disclose the departure in a separate paragraph of the report.
- b. Issue an adverse opinion.
- c. Attach a footnote explaining the effects of the departure.
- d. Issue a compilation report.

**N83#31.** Which of the following will **not** result in modification of the auditor's report due to a scope limitation?

- a. Restrictions imposed by the client.
- b. Reliance placed on the report of another auditor.
- c. Inability to obtain sufficient competent evidential matter.
- d. Inadequacy in the accounting records.

**N83#33.** Which of the following procedures is **not** included in a review engagement of a nonpublic entity?

- a. Inquiries of management.
- b. Inquiries regarding events subsequent to the balance sheet date.
- c. Any procedures designed to identify relationships among data that appear to be unusual.
- d. A study and evaluation of internal control.

**N83#37.** Whenever special reports, filed on a printed form designed by authorities, call upon the independent auditor to make an assertion that the auditor believes is **not** justified, the auditor should

- a. Reword the form or attach a separate report.
- b. Submit a short-form report with explanations.
- c. Submit the form with questionable items clearly omitted.
- d. Withdraw from the engagement.

**N83#54.** The objective of the consistency standard is to provide assurance that

- a. There are **no** variations in the format and presentation of financial statements.
- b. Substantially different transactions and events are **not** accounted for on an identical basis.

- c. The auditor is consulted before material changes are made in the application of accounting principles.
- d. The comparability of financial statements between periods is **not** materially affected by changes in accounting principles without disclosure.

**N83#57.** If a complete set of financial statements is presented on a comparative basis for two years, the auditor's opinion as it applies to the results of operations and changes in financial position would contain which of the following phrases?

- a. The two years then ended.
- b. The years then ended.
- c. Each of the two years ended.
- d. Each of the years in the two-year period ended.

**M83#9.** When comparative financial statements are presented but the predecessor auditor's report is **not** presented, the current auditor should do which of the following in the audit report?

- a. Disclaim an opinion on the prior year's financial statements.
- b. Identify the predecessor auditor who examined the financial statements of the prior year.
- c. Make **no** comment with respect to the predecessor auditor's examination.
- d. Indicate the type of opinion expressed by the predecessor auditor.

**M83#10.** When reporting on financial statements prepared on a comprehensive basis of accounting other than generally accepted accounting principles, the independent auditor should include in the report a paragraph that

- a. States that the financial statements are **not** intended to be in conformity with generally accepted accounting principles.
- b. Justifies the comprehensive basis of accounting being used.
- c. Refers to the authoritative pronouncements that explain the comprehensive basis of accounting being used.
- d. States that the financial statements are **not** intended to have been examined in accordance with generally accepted auditing standards.

**M83#11.** The essence of the attest function is to

- a. Detect fraud.
- b. Examine individual transactions so that the auditor may certify as to their validity.
- c. Determine whether the client's financial statements are fairly stated.
- d. Assure the consistent application of correct accounting procedures.



Selected Questions

**M83#13.** A lawyer limits a response concerning a litigated claim because the lawyer is unable to determine the likelihood of an unfavorable outcome. Which type of opinion should the auditor express if the litigation is adequately disclosed and the range of potential loss is material in relation to the client's financial statements considered as a whole?

- Adverse.
- Unaudited.
- Qualified.
- Unqualified.

**M83#17.** Which of the following should be recognized as a consistency modification in the auditor's report, whether or **not** the item is fully disclosed in the financial statements?

- A change in accounting estimate.
- A change from an unacceptable accounting principle to a generally accepted one.
- Correction of an error **not** involving a change in accounting principle.
- A change in classification.

**M83#25.** A CPA who is **not** independent may issue a

- Review report.
- Comfort letter.
- Qualified opinion.
- Compilation report.

**M83#28.** When the client fails to include information that is necessary for the fair presentation of financial statements in the body of the statements or in the related footnotes, it is the responsibility of the auditor to present the information, if practicable, in the auditor's report and issue a(n)

- Qualified opinion or a disclaimer of opinion.
- Qualified opinion or an adverse opinion.
- Adverse opinion or a disclaimer of opinion.
- Qualified opinion or an unqualified opinion.

**M83#30.** When restrictions that significantly limit the scope of the audit are imposed by the client, the auditor generally should issue which of the following opinions?

- "Except for."
- Disclaimer.
- Adverse.
- "Subject to."

**M83#31.** When an auditor performs a review of interim financial statements, which of the following steps would **not** be part of the review?

- Review of computer controls.
- Inquiry of management.
- Review of ratios and trends.
- Reading the minutes of the stockholders' meetings.

**M83#37.** A company has changed its method of inventory valuation from an unacceptable one to one in

conformity with generally accepted accounting principles. The auditor's report on the financial statements of the year of the change should include

- No reference to consistency.
- A reference to a prior period adjustment.
- A middle paragraph explaining the change.
- A justification for making the change and the impact of the change on reported net income.

**M83#55.** When the financial statements of a nonpublic entity for a prior period have **not** been audited and are presented, for comparative purposes, with current period statements that have been audited,

- The auditor should request removal of the unaudited statements since it is improper to present them for comparative purposes with audited statements.
- The auditor should identify the financial statements that were **not** examined in a separate paragraph in the auditor's report accompanying the current statements.
- The unaudited statements do **not** need to be marked "unaudited" as this may confuse the users of the statements.
- The auditor's report accompanying the statements should **not** mention that the prior period statements are unaudited, but the unaudited statements should be marked "unaudited."

**N82#1.** Negative assurance is **not** permissible in

- Letters required by security underwriters for data pertinent to SEC registration statements.
- Reports relating to the results of agreed upon procedures to one or more specified elements, accounts, or items of a financial statement.
- Reports based upon a review engagement.
- Reports based upon an audit of the interim financial statements of a closely-held business entity.

**N82#4.** Comparative financial statements include the financial statements of a prior period which were examined by a predecessor auditor, whose report is **not** presented. If the predecessor auditor's report was qualified, the successor auditor must

- Express an opinion on the current year statements alone and make **no** reference to the prior year statements.
- Disclose the reasons for any qualification included in the predecessor auditor's opinion.
- Obtain written approval from the predecessor auditor to include the prior year's financial statements.
- Issue a standard short-form comparative report indicating the division of responsibility.

**N82#5.** Higgins Corporation is required to but does not wish to prepare and issue a statement of changes in financial position along with its other basic financial

## Auditing

statements. In these circumstances, the independent auditor's report on the Higgins financial statements should include a (an)

- a. Unqualified opinion with a statement of changes in financial position prepared by the auditor and included as part of the auditor's report.
- b. Qualified opinion with a middle paragraph explaining that the company declined to present the required statement.
- c. Adverse opinion stating that the financial statements, taken as a whole, are **not** fairly presented because of the omission of the required statement.
- d. Disclaimer of opinion with a separate explanatory paragraph stating why the company declined to present the required statement.

**N82#17.** A material change in an accounting estimate

- a. Requires a consistency modification in the auditor's report and disclosure in the financial statements.
- b. Requires a consistency modification in the auditor's report but does **not** require disclosure in the financial statements.
- c. Affects comparability and may require disclosure in a note to the financial statements but does **not** require a consistency modification in the auditor's report.
- d. Involves the acceptability of the generally acceptable accounting principles used.

**N82#20.** The term "special reports" may include all of the following, **except** reports on financial statements

- a. Of an organization that has limited the scope of the auditor's examination.
- b. Prepared for limited purposes such as a report that relates to only certain aspects of financial statements.
- c. Of a not-for-profit organization which follows accounting practices differing in some respects from those followed by business enterprises organized for profit.
- d. Prepared in accordance with historical cost/constant dollar accounting.

**N82#35.** 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. New information comes to the auditor's attention concerning an event which occurred prior to the date of the auditor's report which may have affected the auditor's report.
- b. Material adverse events occur after the date of the auditor's report.

- c. Final determination or resolution was made on matters which had resulted in a qualification in the auditor's report.
- d. Final determination or resolution was made of a contingency which had been disclosed in the financial statements.

**N82#36.** When financial statements of a prior period are presented on a comparative basis with financial statements of the current period, the continuing auditor is responsible for

- a. Expressing dual dated opinions.
- b. Updating the report on the previous financial statements only if there has **not** been a change in the opinion.
- c. Updating the report on the previous financial statements only if the previous report was qualified and the reasons for the qualification no longer exist.
- d. Updating the report on the previous financial statements regardless of the opinion previously issued.

**N82#37.** Skates, an independent auditor, was engaged to perform an examination of the financial statements of Apex Incorporated one month after its fiscal year had ended. Although the inventory count was not observed by Skates, and accounts receivable were not confirmed by direct communication with creditors, Skates was able to gain satisfaction by applying alternative auditing procedures. Skates' auditor's report will probably contain

- a. An "except for" qualification.
- b. An unqualified opinion and an explanatory middle paragraph.
- c. Either a qualified opinion or a disclaimer of opinion.
- d. A standard unqualified opinion.

**N82#39.** In performing a compilation of financial statements of a nonpublic entity, the accountant decides that modification of the standard report is not adequate to indicate deficiencies in the financial statements taken as a whole, and the client is not willing to correct the deficiencies. The accountant should therefore

- a. Perform a review of the financial statements.
- b. Issue a special report.
- c. Withdraw from the engagement.
- d. Express an adverse audit opinion.

**N82#43.** It is **not** appropriate for the auditor's report to refer a reader to a financial statement footnote for details regarding a (an)

- a. Change in accounting principle.
- b. Limitation in the scope of the audit.
- c. Uncertainty.
- d. Related party transaction.

Selected Questions

**N82#58.** Which of the following **best** describes the reference to the expression “taken as a whole” in the fourth generally accepted auditing standard of reporting?

- a. It applies equally to a complete set of financial statements and to each individual financial statement.
- b. It applies only to a complete set of financial statements.
- c. It applies equally to each item in each financial statement.
- d. It applies equally to each material item in each financial statement.

**N82#60.** The auditor is unable to reach a conclusion as to the propriety of management’s representations. The auditor will have to consider issuing a (an)

- a. Opinion qualified because of uncertainty.
- b. Opinion qualified because of inadequate disclosure.
- c. Adverse opinion or a qualified opinion.
- d. Qualified opinion or a disclaimer of opinion.

**M82#16.** An auditor who was engaged to perform an examination of the financial statements of a nonpublic entity has been asked by the client to refrain from performing various audit procedures and change the nature of the engagement to a review of the financial statements in accordance with standards established by the AICPA. The client’s request was made because the cost to complete the examination was significant. Under the circumstances the auditor would most likely

- a. Qualify the auditor’s report and refer to the scope limitation.
- b. View the request as an indication of a possible irregularity.
- c. Complete the examination which was in progress.
- d. Honor the client’s request.

**M82#21.** When a client declines to include a statement of changes in financial position in its financial report, the auditor’s report will usually

- a. Contain a qualified opinion because of inadequate disclosure.
- b. Include a separate paragraph which summarizes the company’s financing and investing activities.
- c. Refer to a footnote which contains an auditor-prepared statement of changes in financial position.
- d. Refer to the scope limitation.

**M82#29.** A change from a cash to working capital presentation in the statement of changes in financial position constitutes a change which requires

- a. Only a disclosure in the auditor’s report.
- b. That the auditor’s opinion contain a “subject to” qualification as to consistency.

- c. That the auditor’s opinion contain an exception as to conformity with generally accepted accounting principles.
- d. That the auditor’s report contain an exception as to consistency in the opinion paragraph.

**M82#41.** Which of the following normally does **not** affect the consistency phrase in the auditor’s standard report?

- a. A change in accounting estimate.
- b. A change in accounting principle.
- c. A change in the companies included in combined financial statements.
- d. A correction of an error in principle.

**M82#50.** For financial reporting purposes, a change from straight-line to an accelerated depreciation method was disclosed in a note to the financial statements and has an **immaterial** effect on the current financial statements. It is expected, however, that the change will have a significant effect on future periods. The auditor should express a (an)

- a. Consistency exception.
- b. Adverse opinion.
- c. Unqualified opinion.
- d. “Subject to” opinion.

**M82#56.** Late in December, Tech Products Company sold its marketable securities which had appreciated in value and then repurchased them the same day. The sale and purchase transactions resulted in a large gain. Without the gain the company would have reported a loss for the year. Which of the following statements with respect to the auditor is correct?

- a. If the sale and repurchase are disclosed, an unqualified opinion should be rendered.
- b. The repurchase transaction is a sham and the auditor should insist upon a reversal or issue an adverse opinion.
- c. The auditor should withdraw from the engagement and refuse to be associated with the company.
- d. A disclaimer of opinion should be issued.

**M82#60.** For reporting purposes, the independent auditor should consider each of the following types of financial presentation to be a financial statement, **except** the statement of

- a. Changes in owners’ equity.
- b. Operations by product lines.
- c. Changes in the elements of working capital.
- d. Cash receipts and disbursements.

**M81#9.** Under which of the following sets of circumstances might an auditor disclaim an opinion?

- a. The financial statements contain a departure from generally accepted accounting principles, the effect of which is material.

## Auditing

- b. The principal auditor decides to make reference to the report of another auditor who audited a subsidiary.
- c. There has been a material change between periods in the method of the application of accounting principles.
- d. There are significant uncertainties affecting the financial statements.

**N81#11.** The management of Stanley Corporation has decided **not** to account for a material transaction in accordance with the provisions of a recent statement of the FASB. They have set forth their reasons in note "B" to the financial statements which clearly demonstrates that due to unusual circumstances the financial statements would otherwise have been misleading. The auditor's report will probably contain a (an)

- a. Consistency exception and a reference to note "B."
- b. Unqualified opinion and an explanatory middle paragraph.
- c. "Subject to" opinion and an explanatory middle paragraph.
- d. "Except for" opinion and an explanatory middle paragraph.

**N81#24.** An auditor includes a middle paragraph in an otherwise unqualified report in order to emphasize that the entity being reported upon is a subsidiary of another business enterprise. The inclusion of this middle paragraph

- a. Is appropriate and would **not** negate the unqualified opinion.
- b. Is considered a qualification of the report.
- c. Is a violation of generally accepted reporting standards if this information is disclosed in footnotes to the financial statements.
- d. Necessitates a revision of the opinion paragraph to include the phrase "with the foregoing explanation."

**N81#31.** A CPA engaged to examine financial statements observes that the accounting for a certain material item is not in conformity with generally accepted accounting principles, and that this fact is prominently disclosed in a footnote to the financial statements. The CPA should

- a. Express an unqualified opinion and insert a middle paragraph emphasizing the matter by reference to the footnote.
- b. Disclaim an opinion.
- c. Not allow the accounting treatment for this item to affect the type of opinion because the deviation from generally accepted accounting principles was disclosed.
- d. Qualify the opinion because of the deviation from generally accepted accounting principles.

**N81#32.** When there is a change in accounting principle with which the auditor concurs, what modification, if any, should be made to the auditor's report?

- a. Modify the consistency phrase and remain silent regarding concurrence.
- b. Modify the consistency phrase and explicitly express concurrence.
- c. Not modify the consistency phrase and remain silent regarding concurrence.
- d. Not modify the consistency phrase but explicitly express concurrence.

**N81#35.** An auditor's report on comparative financial statements should be dated as of the date of the

- a. Issuance of the report.
- b. Completion of the auditor's recent fieldwork.
- c. Latest financial statements being reported on.
- d. Last subsequent event disclosed in the statements.

**N81#56.** A CPA who is **not** independent may issue a

- a. Compilation report.
- b. Review report.
- c. Comfort letter.
- d. Qualified opinion.

**N81#58.** Whenever negative assurance is provided by a CPA, it is based upon

- a. An absence of nullifying evidence.
- b. A presence of substantiating evidence.
- c. An objective examination in accordance with generally accepted auditing standards.
- d. A judgmental determination in accordance with guidelines promulgated by the AICPA.

**M81#2.** Once the initial audit of a newly constructed industrial plant has been performed, with respect to consistency, which of the following is of **least** concern to the continuing auditor in the following year?

- a. Prior years' capitalization policy.
- b. Prior years' capitalized costs.
- c. Prior years' depreciation methods.
- d. Prior years' depreciable life.

**M81#12.** Karr has examined the financial statements of Lurch Corporation for the year ended December 31, 1980. Although Karr's fieldwork was completed on February 27, 1981, Karr's auditor's report was dated February 28, 1981, and was received by the management of Lurch on March 5, 1981. On April 4, 1981, the management of Lurch asked that Karr approve inclusion of this report in their annual report to stockholders which will include unaudited financial statements for the first quarter ended March 31, 1981. Karr approved of the inclusion of this auditor's report in the annual report to stockholders. Under the circumstances Karr is responsible for inquiring as to subsequent events occurring through

- a. February 27, 1981.
- b. February 28, 1981.

*Selected Questions*

- c. March 31, 1981.
- d. April 4, 1981.

**M81#13.** The fourth generally accepted auditing standard of reporting requires an auditor to render a report whenever an auditor's name is associated with financial statements. The overall purpose of the fourth standard of reporting is to require that reports

- a. Assure that the auditor is independent with respect to the financial statements under examination.
- b. State that the auditor's examination of the financial statements has been conducted in accordance with generally accepted auditing standards.
- c. Indicate the character of the auditor's examination and the degree of responsibility assumed.
- d. Express whether the accounting principles used in preparing the financial statements have been applied consistently in the period under examination.

**M81#23.** Which of the following consistency phrases would be contained in a continuing auditor's standard report on comparative financial statements?

- a. Applied on a consistent basis.
- b. Applied on a basis consistent with that of the preceding year.
- c. Applied consistently during interim periods.
- d. Applied consistently with previous years audited.

**M81#29.** Which of the following would **not** be required for the statements to be "presented fairly" in conformity with generally accepted accounting principles?

- a. That generally accepted accounting principles be followed in presenting all material items in the statements.
- b. That the generally accepted accounting principles selected from alternatives be appropriate for the circumstances of the particular company.
- c. That generally accepted accounting principles be applied on a basis consistent with those followed in the prior year.
- d. That the generally accepted accounting principles selected from alternatives reflect transactions in accordance with their substance.

**M81#30.** An auditor is confronted with an exception considered sufficiently material as to warrant some deviation from the standard unqualified auditor's report. If the exception relates to a departure from generally accepted accounting principles, the auditor must decide between expressing a (an)

- a. Adverse opinion and a "subject to" opinion.
- b. Adverse opinion and an "except for" opinion.

- c. Adverse opinion and a disclaimer of opinion.
- d. Disclaimer of opinion and a "subject to" opinion.

**M81#31.** A continuing auditor would update his opinion on prior financial statements by issuing a "subject to" opinion for the

- a. Subsequent resolution of an uncertainty in the current period.
- b. Discovery of an uncertainty in the current period.
- c. Discovery of an uncertainty in the current period that relates to the prior-period statements being reported on.
- d. Restatement of prior-period statements in conformity with generally accepted accounting principles.

**M81#33.** In which of the following circumstances would an adverse opinion be appropriate?

- a. The auditor is not independent with respect to the enterprise being audited.
- b. An uncertainty prevents the issuance of an unqualified opinion.
- c. The statements are **not** in conformity with APB Opinion No. 8 regarding pension plans.
- d. A client-imposed scope limitation prevents the auditor from complying with generally accepted auditing standards.

**M81#42.** An auditor's report would be designated as a special report when it is issued in connection with which of the following?

- a. Financial statements for an interim period which are subjected to a limited review.
- b. Financial statements which are prepared in accordance with a comprehensive basis of accounting other than generally accepted accounting principles.
- c. Financial statements which purport to be in accordance with generally accepted accounting principles but do not include a presentation of the statement of changes in financial position.
- d. Financial statements which are unaudited and are prepared from a client's accounting records.

**M81#52.** Before reissuing a report which was previously issued on the financial statements of a prior period, a predecessor auditor should

- a. Review the successor auditor's working papers.
- b. Examine significant transactions or events since the date of previous issuance.
- c. Obtain a signed engagement letter from the client.
- d. Obtain a letter of representation from the successor auditor.

**M81#53.** A modification of the CPA's report on a review of the interim financial statements of a publicly-held company would be necessitated by which of the following?

- a. An uncertainty.
- b. Lack of consistency.
- c. Reference to another accountant.
- d. Inadequate disclosure.

**N80#9.** Stone was asked to perform the first audit of a wholesale business that does **not** maintain perpetual inventory records. Stone has observed the current inventory but has **not** observed the physical inventory at the previous year-end date and concludes that the opening inventory balance, which is **not** auditable, is a material factor in the determination of cost of goods sold for the current year. Stone will probably

- a. Decline the engagement.
- b. Express an unqualified opinion on the balance sheet and income statement except for inventory.
- c. Express an unqualified opinion on the balance sheet and disclaim an opinion on the income statement.
- d. Disclaim an opinion on the balance sheet and income statement.

**N80#15.** The annual report of a publicly held company presents the prior year's financial statements which are clearly marked "unaudited" in comparative form with current year audited financial statements. The auditor's report should

- a. Express an opinion on the audited financial statements and contain a separate paragraph describing the responsibility assumed for the financial statements of the prior period.
- b. Disclaim an opinion on the unaudited financial statements, modify the consistency phrase, and express an opinion on the current year's financial statements.
- c. State that the unaudited financial statements are presented solely for comparative purposes and express an opinion only on the current year's financial statements.
- d. Express an opinion on the audited financial statements and state whether the unaudited financial statements were compiled or reviewed.

**N80#22.** A note to the financial statements of the First Security Bank indicates that all of the records relating to the bank's business operations are stored on magnetic discs, and that there are no emergency back-up systems or duplicate discs stored since the First Security Bank and their auditors consider the occurrence of a catastrophe to be remote. Based upon this, one would expect the auditor's report to express

- a. A "subject to" opinion.
- b. An "except for" opinion.

- c. An unqualified opinion.
- d. A qualified opinion.

**N80#24.** Which of the following should be recognized in the auditor's report, whether or **not** the item is fully disclosed in the financial statements?

- a. A change in accounting estimate.
- b. Correction of an error not involving a change in accounting principle.
- c. A change from a nonaccepted accounting principle to a generally accepted one.
- d. A change in classification.

**N80#28.** Which of the following statements with respect to an auditor's report expressing an opinion on a specific item on a financial statement is correct?

- a. Materiality must be related to the specified item rather than to the financial statements taken as a whole.
- b. Such a report can only be expressed if the auditor is also engaged to audit the entire set of financial statements.
- c. The attention devoted to the specified item is usually less than it would be if the financial statements taken as a whole were being audited.
- d. The auditor who has issued an adverse opinion on the financial statements taken as a whole can never express an opinion on a specified item in these financial statements.

**N80#32.** The objective of a review of the interim financial information of a publicly held company is to

- a. Provide the accountant with a basis for the expression of an opinion.
- b. Estimate the accuracy of financial statements based upon limited tests of accounting records.
- c. Provide the accountant with a basis for reporting to the board of directors or stockholders.
- d. Obtain corroborating evidential matter through inspection, observation and confirmation.

**N80#45.** A CPA has audited financial statements and issued an unqualified opinion on them. Subsequently the CPA was requested to compile financial statements for the same period that omit substantially all disclosures and are to be used for comparative purposes. In these circumstances the CPA may report on comparative compiled financial statements that omit such disclosures provided the

- a. Missing disclosures are immaterial in amount.
- b. Financial statements and notes appended thereto are not misleading.
- c. Accountant's report indicates the previous audit and the date of the previous report.
- d. Previous auditor's report accompanies the comparative financial statement.

## *Selected Questions*

**N80#56.** A company issues audited financial statements under circumstances which require the presentation of a statement of changes in financial position. If the company refuses to present a statement of changes in financial position, the independent auditor should

- a. Disclaim an opinion.
- b. Prepare a statement of changes in financial position and note in a middle paragraph of the report that this statement is auditor-prepared.
- c. Prepare a statement of changes in financial position and disclose in a footnote that this statement is auditor-prepared.
- d. Qualify his opinion with an "except for" qualification and a description of the omission in a middle paragraph of the report.

**M80#3.** Under which of the following circumstances could an auditor consider rendering an opinion on pro forma statements that give effect to proposed transactions?

- a. When the proposed transactions are subject to a definitive agreement among the parties.
- b. When the time interval between the date of the financial statements and consummation of the transactions is relatively long.
- c. When certain subsequent events have some chance of interfering with the consummation of the transactions.
- d. When the pro forma statements include amounts based on financial projections.

**M80#6.** Which of the following, when materially affecting comparability, would ordinarily be referred to by an independent auditor reporting on the statement of changes in financial position?

- a. Changing from a balanced to an unbalanced form of presentation.
- b. Changes in terminology.
- c. Changing from a cash to working capital form of presentation.
- d. Changes in the content of working capital.

**M80#20.** An auditor is reporting on cash-basis financial statements. These statements are **best** referred to in his opinion by which one of the following descriptions?

- a. Financial position and results of operations arising from cash transactions.
- b. Assets and liabilities arising from cash transactions, and revenue collected and expenses paid.
- c. Balance sheet and income statement resulting from cash transactions.
- d. Cash balance sheet and the source and application of funds.

**M80#26.** In a first audit of a new company the auditor's report will

- a. Remain silent with respect to consistency.
- b. State that the accounting principles have been applied on a consistent basis.
- c. State that accounting principles have been applied consistently during the period.
- d. State that the consistency standard does **not** apply because the current year is the first year of audit.

**M80#36.** Jones, CPA, is the principal auditor who is auditing the consolidated financial statements of his client. Jones plans to refer to another CPA's examination of the financial statements of a subsidiary company but does **not** wish to present the other CPA's audit report. Both Jones's and the other CPA's audit reports have noted no exceptions to generally accepted accounting principles. Under these circumstances the opinion paragraph of Jones's consolidated audit report should express

- a. An unqualified opinion.
- b. A "subject to" opinion.
- c. An "except for" opinion.
- d. A principal opinion.

**M80#48.** When an adverse opinion is expressed, the opinion paragraph should include a direct reference to

- a. A footnote to the financial statements which discusses the basis for the opinion.
- b. The scope paragraph which discusses the basis for the opinion rendered.
- c. A separate paragraph which discusses the basis for the opinion rendered.
- d. The consistency or lack of consistency in the application of generally accepted accounting principles.

**M80#53.** An auditor need **not** mention consistency in the audit report if

- a. The client has acquired another company through a "pooling of interests."
- b. An adverse opinion is issued.
- c. This is the first year the client has had an audit.
- d. Comparative financial statements are issued.

### **B. Other Reporting Considerations**

**N84#4.** Which of the following best describes the auditor's responsibility for "other information" included in the annual report to stockholders which contains financial statements and the auditor's report?

- a. The auditor has **no** obligation to read the "other information."
- b. The auditor has **no** obligation to corroborate the "other information," but should read the "other information" to determine whether it is materially inconsistent with the financial statements.

## Auditing

- c. The auditor should extend the examination to the extent necessary to verify the "other information."
- d. The auditor must modify the auditor's report to state that the "other information is unaudited" or "not covered by the auditor's report."

**N84#6.** The auditor's report should be dated as of the date on which the

- a. Report is delivered to the client.
- b. Field work is completed.
- c. Fiscal period under audit ends.
- d. Review of the working papers is completed.

**N84#7.** If information accompanying the basic financial statements in an auditor-submitted document has been subjected to auditing procedures, the auditor may express an opinion which states that the accompanying information is fairly stated in

- a. Conformity with generally accepted accounting principles.
- b. Terms of negative assurance.
- c. All material respects in relation to the basic financial statements taken as a whole.
- d. Conformity with principles for presenting accompanying information.

**N84#12.** In which of the following circumstances may the auditor issue the standard audit report?

- a. The principal auditor assumes responsibility for the work of another auditor.
- b. The financial statements are affected by a departure from a generally accepted accounting principle.
- c. The auditor's report covers the company's first year of operations.
- d. The auditor wishes to emphasize a matter regarding the financial statements.

**N84#30.** The auditor's inquiries of management regarding supplementary information on the effects of price level changes should be directed to the judgments made concerning

- a. Relevance and validity.
- b. Measurement and presentation.
- c. Accuracy and objectivity.
- d. Rights and obligations.

**N84#34.** Comfort letters are ordinarily signed by the

- a. Independent auditor.
- b. Client.
- c. Client's lawyer.
- d. Internal auditor.

**N84#60.** When the principal auditor decides to make reference to the other auditor's examination, the principal auditor's report should always indicate clearly, in both the scope and opinion paragraphs, the

- a. Magnitude of the portion of the financial statements examined by the other auditor.
- b. Name of the other auditor.
- c. Division of responsibility.
- d. Disclaimer of responsibility with respect to the portion of the financial statements examined by the other auditor.

**M84#28.** The principal auditor is satisfied with the independence and professional reputation of the other auditor who has audited a subsidiary. To indicate the division of responsibility, the principal auditor should modify

- a. Only the scope paragraph of the report.
- b. Only the opinion paragraph of the report.
- c. Both the scope and opinion paragraphs of the report.
- d. Only the opinion paragraph of the report and include an explanatory middle paragraph.

**M84#42.** Jones, CPA, examined the 1983 financial statements of Ray Corp. and issued an unqualified opinion on March 10, 1984. On April 2, 1984, Jones became aware of a 1983 transaction that may materially affect the 1983 financial statements. This transaction would have been investigated had it come to Jones' attention during the course of the examination. Jones should

- a. Take **no** action because an auditor is **not** responsible for events subsequent to the issuance of the auditor's report.
- b. Contact Ray's management and request their cooperation in investigating the matter.
- c. Request that Ray's management disclose the possible effects of the newly discovered transaction by adding an unaudited footnote to the 1983 financial statements.
- d. Contact all parties who might rely upon the financial statements and advise them that the financial statements are misleading.

**M84#58.** When an auditor submits a document containing audited financial statements to a client, the auditor has a responsibility to report on

- a. Only the basic financial statements included in the document.
- b. The basic financial statements and only that additional information required to be presented in accordance with provisions of the Financial Accounting Standards Board.
- c. All of the information included in the document.
- d. Only that portion of the document which was audited.

**N83#29.** A financial forecast is an estimate of financial position, results of operations, and changes in financial position that, to the best of management's knowledge, is

- a. At the midpoint of a given precision range.
- b. At the low point of a given precision range.



*Selected Questions*

- c. Conservative.
- d. Most probable.

**N83#58.** An auditor's report contains the following sentences:

We did not examine the financial statements of B Company, a consolidated subsidiary, which statements reflect total assets and revenues constituting 20 percent and 22 percent, respectively, of the related consolidated totals. These statements were examined by other auditors whose report thereon has been furnished to us, and our opinion expressed herein, insofar as it relates to the amounts included for B Company, is based solely upon the report of the other auditors.

These sentences

- a. Disclaim an opinion.
- b. Qualify the opinion.
- c. Divide responsibility.
- d. Are an improper form of reporting.

**N83#59.** After issuance of the auditor's report, the auditor has **no** obligation to make any further inquiries with respect to audited financial statements covered by an auditor's report unless a

- a. Contingency is resolved.
- b. Development occurs which may affect the client's ability to continue as a going concern.
- c. Material defalcation ensues.
- d. History of significant non-arms-length related party transactions is discovered.

**M83#26.** If the principal auditor decides to make reference to the other auditor's examination, the scope paragraph must specifically indicate the

- a. Magnitude of the portion of the financial statements examined by the other auditor.
- b. Name of the other auditor.
- c. Name of the consolidated subsidiary examined by the other auditor.
- d. Type of opinion expressed by the other auditor.

**M83#27.** A closely-held manufacturing company must disclose all of the following information in audited financial statements **except**

- a. Replacement cost of inventory.
- b. Any pledged inventory.
- c. LIFO reserves.
- d. Any changes in methods of accounting for inventory.

**M83#43.** During the current examination, an auditor who issued an unqualified report on the prior year's financial statements becomes aware of a material unresolved uncertainty that affects the prior year financial statements presented with the current year financial statements. The auditor should

- a. Qualify or disclaim an opinion in the updated report on the prior year's financial statements.
- b. Not change the opinion on the prior year's financial statements because the uncertainty remains unresolved.
- c. Express an adverse opinion in the updated report on the prior year's financial statements.
- d. Express an opinion only on the current year's financial statements.

**N82#23.** Morgan, CPA, is the principal auditor for a multinational corporation. Another CPA has examined and reported on the financial statements of a significant subsidiary of the corporation. Morgan is satisfied with the independence and professional reputation of the other auditor, as well as the quality of the other auditor's examination. With respect to Morgan's report on the consolidated financial statements, taken as a whole, Morgan

- a. Must **not** refer to the examination of the other auditor.
- b. Must refer to the examination of the other auditor.
- c. May refer to the examination of the other auditor.
- d. May refer to the examination of the other auditor, in which case Morgan must include in the auditor's report on the consolidated financial statements a qualified opinion with respect to the examination of the other auditor.

**N82#34.** When reporting on financial statements that are required to include segment information, the auditor's quantitative measurement of materiality with respect to segment information should be

- a. Disclosed.
- b. Primarily related to the segment information alone.
- c. Primarily related to the financial statements taken as a whole.
- d. Disregarded.

**N82#41.** An accountant's compilation report should be dated as of the date of

- a. Completion of fieldwork.
- b. Completion of the compilation.
- c. Transmittal of the compilation report.
- d. The latest subsequent event referred to in the notes to the financial statements.

**M82#4.** In an audit situation, communication between successor and predecessor auditors should be

- a. Authorized in an engagement letter.
- b. Acknowledged in a representation letter.
- c. Either written or oral.
- d. Written and included in the working papers.

## *Auditing*

**M82#9.** A CPA who is associated with the financial statements of a public entity, but has **not** audited or reviewed such statements, should

- a. Insist that they be audited or reviewed before publication.
- b. Read them to determine whether there are obvious material errors.
- c. State these facts in the accompanying notes to the financial statements.
- d. Issue a compilation report.

**M82#31.** Basic financial statements which would otherwise receive an unqualified opinion do not contain certain supplementary information that is required to be presented pursuant to an FASB pronouncement. The auditor must identify, in an additional paragraph, the supplementary information that is omitted and express a (an)

- a. "Except for" opinion.
- b. Disclaimer of opinion.
- c. Adverse opinion.
- d. Unqualified opinion.

**N81#42.** When financial statements examined by the independent auditor contain notes which are captioned "unaudited" or "not covered by the auditor's report," the auditor

- a. May refer to these notes in the auditor's report.
- b. Has **no** responsibility with respect to information contained in these notes.
- c. Must refer to these notes in the auditor's report.
- d. Is precluded from referring to these notes in the auditor's report.

**N81#51.** The principal auditor is satisfied with the independence and professional reputation of the other

auditor who has audited a subsidiary but wants to indicate the division of responsibility. The principal auditor should

- a. Modify the scope paragraph of the report.
- b. Modify the scope and opinion paragraphs of the report.
- c. Not modify the report except for inclusion of an explanatory middle paragraph.
- d. Modify the opinion paragraph of the report.

**N81#59.** 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.
- 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.

**M81#54.** Thomas, CPA, has examined the consolidated financial statements of Kass Corporation. Jones, CPA, has examined the financial statements of the sole subsidiary which is material in relation to the total examined by Thomas. It would be appropriate for Thomas to serve as the principal auditor, but it is impractical for Thomas to review the work of Jones. Assuming an unqualified opinion is expressed by Jones, one would expect Thomas to

- a. Refuse to express an opinion on the consolidated financial statements.
- b. Express an unqualified opinion on the consolidated financial statements and not refer to the work of Jones.
- c. Express an unqualified opinion on the consolidated financial statements and refer to the work of Jones.
- d. Express an "except for" opinion on the consolidated financial statements and refer to the work of Jones.

**SELECTED MULTIPLE CHOICE ITEMS — UNOFFICIAL ANSWERS**

**I. Professional Responsibilities**

**A. General Standards and Rules of Conduct**

- N84# 1 d
- N84# 2 c
- N84# 37 b
- N84# 46 d
- N84# 59 b
- M84# 1 b
- M84#51 a
- M84#54 a
- N83# 8 b
- N83# 19 c
- N83# 36 b
- N83# 46 a
- N83# 55 b
- N83# 56 b
- N82# 47 a
- N82# 48 b
- N82# 49 b
- M82#20 d
- M82#23 a
- M82#25 b
- M82#33 c
- M82#43 a
- M82#48 c

- N81# 1 c
- N81# 5 a
- N81# 19 c
- N81# 23 b
- N81# 43 d
- M81#48 d
- M81#49 d
- N80# 5 a
- N80# 13 d
- N80# 26 c
- N80# 37 d
- N80# 39 d
- N80# 55 b
- M80#39 d

- N82# 7 b
- N82# 15 c
- M82# 7 d
- M82#35 d
- M82#47 c
- M82#59 d
- N81# 13 d
- N81# 14 d
- M81#36 d
- M81#58 a
- N80# 10 b
- N80# 48 d
- N80# 53 b
- M80#32 b
- M80#58 c

- N83# 49 a
- N83# 50 c
- N83# 53 a
- N83# 60 b
- M83# 8 a
- M83#48 b
- M83#56 c
- N82# 2 c
- N82# 45 a
- N82# 53 d
- M82#11 d
- M82#34 c
- M82#39 b
- M82#52 a
- N81# 18 d
- N81# 30 d
- N81# 45 a
- M81#38 a
- M81#41 d
- M81#46 d
- M81#56 a
- M81#57 a
- N80# 4 a
- N80# 11 c
- N80# 33 b
- M80# 2 d
- M80#22 c

**B. Control of the Audit**

- N84# 21 d
- N84# 55 b
- M84# 8 d
- M84#33 d
- N83# 40 d
- N83# 48 c
- M83#34 d
- M83#44 d
- M83#57 a

**C. Other Responsibilities**

- N84# 3 d
- N84# 20 c
- N84# 43 a
- N84# 45 d
- N84# 54 d
- M84#40 c
- N83# 11 d
- N83# 23 a
- N83# 44 d

**II. Internal Control**

**A. Definitions and Basic Concepts**

- N84# 15 d
- M84# 5 c
- M84#44 c
- N83# 52 d
- M83#16 a
- M83#22 c
- M83#24 b
- M83#39 d
- M83#45 b
- M83#59 a

- M83#60 a
- N82# 11 a
- N82# 24 c
- N82# 26 a
- N82# 51 a
- M82#24 a
- M82#44 d
- N81# 26 b
- M81# 7 c
- M81# 8 b
- M81#15 d
- M81#22 c
- M80# 7 d

**B. Study and Evaluation of the System**

- N84# 42 b
- M84#16 c
- M84#25 d
- M84#41 d
- N83# 10 a
- N83# 15 a
- N83# 42 c
- N83# 43 b
- M83# 7 b
- M83#20 b

- M83#21 d
- M83#40 a
- N82# 9 a
- N82# 14 b
- N82# 27 b
- N82# 29 c
- M82# 8 c
- M82#13 c
- M82#45 c
- M82#46 b
- N81# 3 d
- N81# 6 b
- N81# 16 d

## Auditing

M81#50 a  
M81#60 d  
N80# 2 d  
N80# 8 b  
N80# 12 c  
N80# 14 b  
N80# 44 b  
M80#41 b  
M80#47 c  
M80#50 c

M82#18 d  
M82#32 c  
M82#38 d  
M82#51 a  
M82#55 d  
M82#57 c  
N81# 4 d  
N81# 15 c  
N81# 39 a  
M81# 9 c  
M81#28 d  
M81#51 a  
M81#59 a  
N80# 35 c  
N80# 40 b  
N80# 52 a  
M80#56 c

M84#10 a  
M84#13 d  
M84#14 d  
M84#15 a  
M84#20 a  
M84#24 b  
M84#32 c  
M84#37 d  
M84#55 c  
N83# 3 c  
N83# 4 c  
N83# 7 b  
N83# 12 a  
N83# 21 d  
N83# 22 a  
N83# 27 a  
N83# 32 b  
N83# 34 a  
N83# 35 a  
N83# 41 b  
M83# 2 b  
M83# 5 a  
M83# 6 a  
M83#35 c  
M83#41 b  
M83#47 b  
M83#54 d  
N82# 32 d

N82# 38 d  
N82# 42 c  
N82# 50 b  
N82# 54 a  
N82# 59 c  
M82# 1 c  
M82# 2 c  
M82# 5 b  
M82#42 b  
M82#54 b  
N81# 7 c  
N81# 8 d  
N81# 10 d  
N81# 29 b  
N81# 50 b  
N81# 53 d  
N81# 55 d  
M81# 3 d  
M81# 6 a  
M81#20 b  
M81#34 d  
M81#35 a  
M81#44 a  
N80# 43 b  
N80# 47 b  
M80#10 d  
M80#43 d  
M80#59 d

### C. Cycles

N84# 36 c  
N84# 44 b  
N84# 48 c  
M84#34 c  
M84#47 c  
M84#48 d  
M84#56 d  
N83# 6 b  
N83# 20 a  
N83# 38 c  
M83#15 b  
M83#23 d  
N82# 3 d  
N82# 19 b

### D. Other Considerations

N84# 9 c  
N84# 10 d  
N84# 16 d  
N84# 32 a  
N84# 39 a  
N84# 57 c

## III. Audit Evidence and Procedures

### A. Audit Evidence

N84# 17 a  
N84# 18 c  
N84# 24 a  
N84# 26 b  
N84# 33 d  
N84# 35 a  
N84# 40 b  
N84# 49 d  
N84# 56 b  
M84# 2 a  
M84# 6 a  
M84#11 c  
M84#19 b  
M84#22 b  
M84#23 c  
M84#26 d  
M84#27 b  
M84#29 c  
M84#31 b  
M84#35 c  
M84#36 b  
M84#50 a  
M84#60 c  
N83# 2 c  
N83# 5 c  
N83# 14 a  
N83# 24 a

N83# 25 d  
N83# 39 a  
N83# 45 c  
N83# 47 c  
N83# 51 d  
M83# 3 d  
M83# 4 c  
M83#19 c  
M83#32 c  
M83#33 b  
M83#36 b  
M83#38 c  
M83#46 b  
M83#49 d  
M83#50 c  
M83#51 b  
M83#52 d  
N82# 6 c  
N82# 8 d  
N82# 10 c  
N82# 25 a  
N82# 28 d  
N82# 30 d  
N82# 31 a  
N82# 55 d  
M82# 6 d  
M82#10 d  
M82#12 d  
M82#14 a

M82#15 b  
M82#19 c  
M82#22 c  
M82#36 b  
M82#49 d  
M82#58 d  
N81# 2 c  
N81# 20 d  
N81# 27 c  
N81# 28 a  
N81# 34 c  
N81# 36 a  
N81# 44 d  
N81# 47 a  
N81# 57 a  
M81# 4 d  
M81#10 d  
M81#14 c  
M81#16 b  
M81#17 a  
M81#19 d  
M81#25 d  
M81#26 c  
M81#27 d  
M81#37 b  
M81#43 b  
M81#55 d  
N80# 6 b  
N80# 18 a

N80# 21 d  
N80# 23 a  
N80# 30 c  
N80# 36 d  
N80# 49 d  
N80# 50 d  
N80# 57 a  
N80# 58 b  
M80# 1 c  
M80# 8 b  
M80# 9 b  
M80#11 a  
M80#15 d  
M80#29 c  
M80#30 d  
M80#37 d  
M80#45 c  
M80#49 d

### B. Specific Audit Objectives and Procedures

N84# 23 a  
N84# 27 b  
N84# 28 a

Unofficial Answers

N84# 31 b  
N84# 47 c  
M84#12 c  
M84#49 b  
M83#12 b  
M83#42 c  
N82# 12 d  
N82# 13 a  
N82# 16 c  
N82# 18 b  
N82# 52 d  
N82# 56 b  
M82#40 b  
N81# 21 b  
N81# 22 a  
N81# 37 c  
N81# 40 b  
N81# 46 c  
N81# 48 d  
N81# 49 b

M81#39 a  
M81#40 a  
M81#45 a  
N80# 7 a  
N80# 20 c  
N80# 29 c  
N80# 31 c  
N80# 34 c  
N80# 38 a  
N80# 42 c  
N80# 46 d  
N80# 51 d  
N80# 54 b  
N80# 60 a  
M80# 4 d  
M80#12 a  
M80#28 a  
M80#31 a  
M80#34 c  
M80#35 b

M80#40 b  
M80#44 c  
M80#52 d  
M80#57 a

N82# 40 c  
N82# 44 c  
M82#17 a  
M82#27 b  
M82#53 c  
N81# 12 c  
N81# 25 d  
N81# 38 c  
N81# 52 c  
M81#11 a  
M81#18 d  
M81#21 d  
N80# 16 d  
N80# 25 c  
N80# 41 b  
M80# 5 b  
M80#17 b  
M80#18 b  
M80#21 d  
M80#60 d

C. Other Specific Topics

N84# 11 a  
N84# 13 a  
N84# 14 b  
N84# 19 a  
N84# 29 c  
N84# 38 d  
M84# 7 d  
M84#21 d  
M84#30 d  
M84#46 b  
N83# 13 a  
M83# 1 b  
M83#53 d

IV. Reporting

A. Reporting Standards and Types of Reports

N84# 5 b  
N84# 8 c  
N84# 22 c  
N84# 25 d  
N84# 41 d  
N84# 50 d  
N84# 51 d  
N84# 52 d  
N84# 53 c  
N84# 58 a  
M84# 3 a  
M84# 4 b  
M84# 9 c  
M84#17 b  
M84#18 c  
M84#39 a  
M84#43 d  
M84#45 a  
M84#52 b  
M84#53 b  
M84#57 c  
M84#59 b  
N83# 1 d  
N83# 16 b  
N83# 17 b  
N83# 18 c  
N83# 26 d  
N83# 28 d  
N83# 30 a  
N83# 31 b

N83# 33 d  
N83# 37 a  
N83# 54 d  
N83# 57 b  
M83# 9 d  
M83#10 a  
M83#11 c  
M83#13 c  
M83#17 b  
M83#25 d  
M83#28 b  
M83#30 b  
M83#31 a  
M83#37 b  
M83#55 b  
N82# 1 d  
N82# 4 b  
N82# 5 b  
N82# 17 c  
N82# 20 a  
N82# 35 a  
N82# 36 d  
N82# 37 d  
N82# 39 c  
N82# 43 b  
N82# 58 a  
N82# 60 d  
M82#16 d  
M82#21 a  
M82#29 d  
M82#41 a  
M82#50 c  
M82#56 a

M82#60 c  
N81# 9 d  
N81# 11 b  
N81# 24 a  
N81# 31 d  
N81# 32 b  
N81# 35 b  
N81# 56 a  
N81# 58 a  
M81# 2 b  
M81#12 b  
M81#13 c  
M81#23 a  
M81#29 c  
M81#30 b  
M81#31 c  
M81#33 c  
M81#42 b  
M81#52 d  
M81#53 d  
N80# 9 c  
N80# 15 a  
N80# 22 c  
N80# 24 c  
N80# 28 a  
N80# 32 c  
N80# 45 c  
N80# 56 d  
M80# 3 a  
M80# 6 c  
M80#20 b  
M80#26 a  
M80#36 a

M80#48 c  
M80#53 b

B. Other Reporting Considerations

N84# 4 b  
N84# 6 b  
N84# 7 c  
N84# 12 a  
N84# 30 b  
N84# 34 a  
N84# 60 c  
M84#28 c  
M84#42 b  
M84#58 c  
N83# 29 d  
N83# 58 c  
N83# 59 d  
M83#26 a  
M83#27 a  
M83#43 a  
N82# 23 c  
N82# 34 c  
N82# 41 b  
M82# 4 c  
M82# 9 b  
M82#31 d  
N81# 42 a  
N81# 51 b  
N81# 59 a  
M81#54 c



## ESSAYS — SELECTED QUESTIONS

### I. Professional Responsibilities

**M84**

**Number 3 (Estimated time — 15 to 25 minutes)**

The audit committee of the Board of Directors of Unicorn Corp. asked Tish & Field, CPAs, to audit Unicorn's financial statements for the year ended December 31, 1983. Tish & Field explained the need to make an inquiry of the predecessor auditor and requested permission to do so. Unicorn's management agreed, and authorized the predecessor auditor to respond fully to Tish & Field's inquiries.

After a satisfactory communication with the predecessor auditor, Tish & Field drafted an engagement letter that was mailed to the audit committee of the Board of Directors of Unicorn Corp. The engagement letter clearly set forth arrangements concerning the involvement of the predecessor auditor and other matters.

**Required:**

- a. What information should Tish & Field have obtained during their inquiry of the predecessor auditor prior to acceptance of the engagement?
- b. Describe what other matters would Tish & Field generally have included in the engagement letter?

**M80**

**Number 2 (Estimated time — 15 to 25 minutes)**

Savage, CPA, has been requested by an audit client to perform a non-recurring engagement involving

the implementation of an EDP information and control system. The client requests that in setting up the new system and during the period prior to conversion to the new system, Savage:

- Counsel on potential expansion of business activity plans.
- Search for and interview new personnel.
- Hire new personnel.
- Train personnel.

In addition, the client requests that during the three months subsequent to the conversion, Savage:

- Supervise the operation of the new system.
- Monitor client-prepared source documents and make changes in basic EDP generated data as Savage may deem necessary without concurrence of the client. Savage responds that he may perform some of the services requested, but not all of them.

**Required:**

- a. Which of these services may Savage perform and which of these services may Savage not perform?
- b. Before undertaking this engagement, Savage should inform the client of all significant matters related to the engagement. What are these significant matters?
- c. If Savage adds to his staff an individual who specializes in developing computer systems, what degree of knowledge must Savage possess in order to supervise the specialist's activities?

### II. Internal Control

#### A. Definitions and Basic Concepts

**M82**

**Number 3 (Estimated time — 15 to 25 minutes)**

Jones, CPA, who has been engaged to examine the financial statements of Ajax Inc., is about to commence a study and evaluation of Ajax's system of in-

ternal control and is aware of the inherent limitations that should be considered.

**Required:**

- a. What are the objectives of a system of internal accounting control?
- b. What are the reasonable assurances that are intended to be provided by the system of internal accounting control?

## Auditing

c. When considering the potential effectiveness of any system of internal accounting control what are the inherent limitations that should be recognized?

**N81**

**Number 4 (Estimated time — — 15 to 25 minutes)**

Johnson, CPA, was engaged to examine the financial statements of Horizon Incorporated, which has its own computer installation. During the preliminary review, Johnson found that Horizon lacked proper segregation of the programming and operating functions. As a result, Johnson intensified the study and evaluation of the system of internal control surrounding the computer and concluded that the existing compensating general controls provided reasonable assurance that the objectives of the system of internal control were being met.

**Required:**

a. In a properly functioning EDP environment, how is the separation of the programming and operating functions achieved?

b. What are the compensating general controls that Johnson most likely found? **Do not discuss hardware and application controls.**

**B. Study and Evaluation of the System**

**N84**

**Number 3 (Estimated time — — 15 to 25 minutes)**

Cassandra Corporation, a manufacturing company, periodically invests large sums in marketable equity securities. The investment policy is established by the Investment Committee of the Board of Directors, and the treasurer is responsible for carrying out the

Investment Committee's directives. All securities are stored in a bank safe deposit vault.

The independent auditor's internal control questionnaire with respect to Cassandra's investments in marketable equity securities contains the following three questions:

- Is investment policy established by the Investment Committee of the Board of Directors?
- Is the treasurer solely responsible for carrying out the Investment Committee's directives?
- Are all securities stored in a bank safe deposit vault?

**Required:**

In addition to the above three questions, what questions should the auditor's internal control questionnaire include with respect to the company's investments in marketable equity securities?

**M81**

**Number 4 (Estimated time — — 15 to 25 minutes)**

Taylor, a CPA, has been engaged to audit the financial statements of University Books, Incorporated. University Books maintains a large revolving cash fund exclusively for the purpose of buying used books from students for cash. The cash fund is active all year because the nearby university offers a large variety of courses with varying starting and completion dates throughout the year.

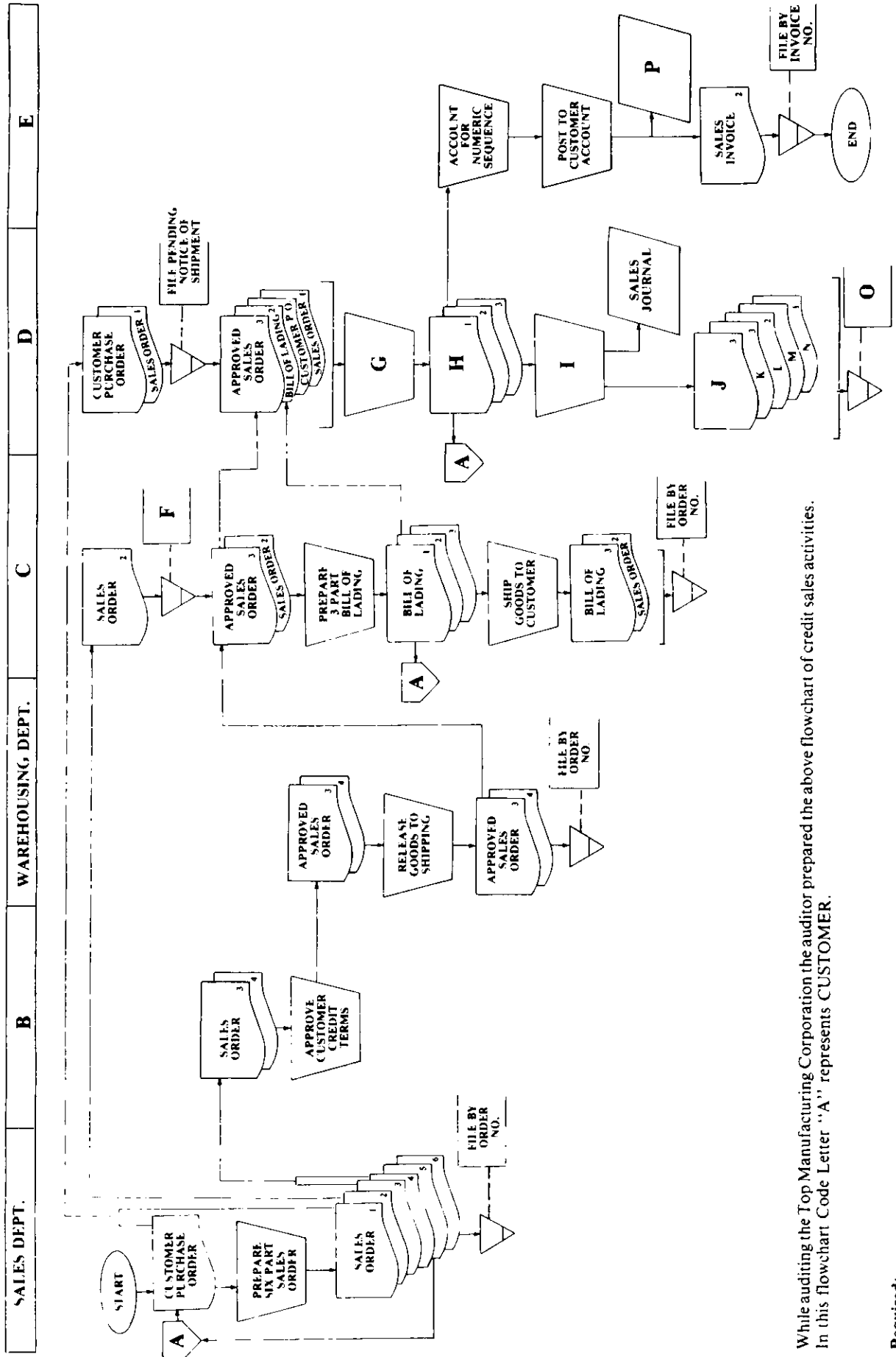
Receipts are prepared for each purchase and reimbursement vouchers are periodically submitted.

**Required:**

Construct an internal control questionnaire to be used in the evaluation of the system of internal control of University Books's buying segments revolving cash fund. The internal control questionnaire should elicit a yes or no response. **Do not discuss the internal controls over books that are purchased.**



**N84**  
**Number 4 (Estimated time — 15 to 25 minutes)**  
**TOP MANUFACTURING CORPORATION**  
**Flowchart of Credit Sales Activities**



While auditing the Top Manufacturing Corporation the auditor prepared the above flowchart of credit sales activities. In this flowchart Code Letter "A" represents CUSTOMER.

**Required:** Indicate what each of the code letters "B" through "P" represents. Do not discuss adequacies or inadequacies in the system of internal control.

**M84**

**Number 4 (Estimated time — — 15 to 25 minutes)**

Talbert Corporation hired an independent computer programmer to develop a simplified payroll application for its newly purchased computer. The programmer developed an on-line, data-based micro-computer system that minimized the level of knowledge required by the operator. It was based upon typing answers to input cues that appeared on the terminal's viewing screen, examples of which follow:

- A. Access routine:
  - 1. Operator access number to payroll file?
  - 2. Are there new employees?
  
- B. New employees routine:
  - 1. Employee name?
  - 2. Employee number?
  - 3. Social security number?
  - 4. Rate per hour?

- 5. Single or married?
- 6. Number of dependents?
- 7. Account distribution?

- C. Current payroll routine:
  - 1. Employee number?
  - 2. Regular hours worked?
  - 3. Overtime hours worked?
  - 4. Total employees this payroll period?

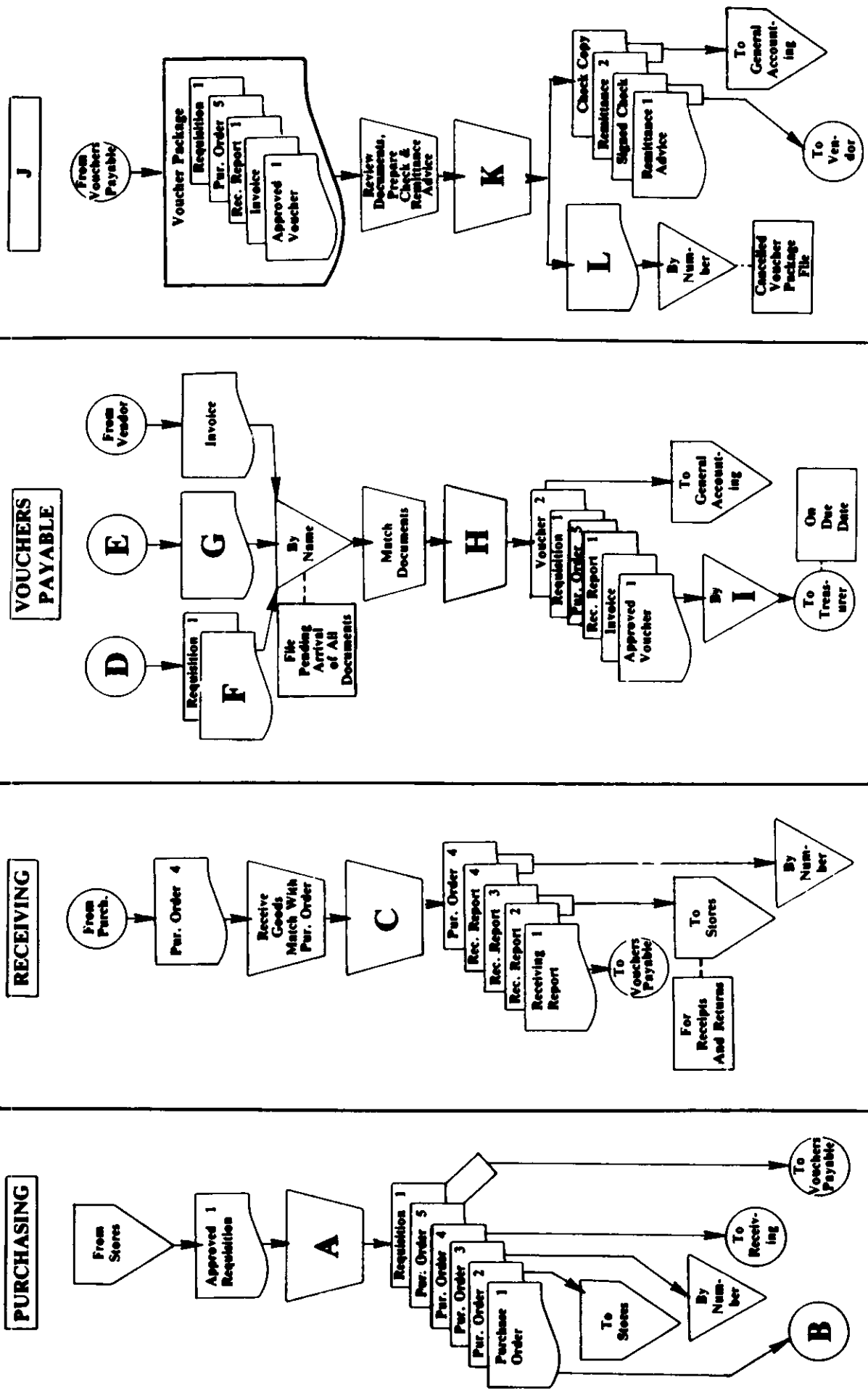
The independent auditor is attempting to verify that certain input validation (edit) checks exist to ensure that errors resulting from omissions, invalid entries, or other inaccuracies will be detected during the typing of answers to the input cues.

**Required:**

Identify the various types of input validation (edit) checks the independent auditor would expect to find in the EDP system. Describe the assurances provided by each identified validation check. Do not discuss the review and evaluation of these controls.



The following illustrates a MANUAL SYSTEM FOR EXECUTING PURCHASES AND CASH DISBURSEMENTS TRANSACTIONS



Required: Indicate what each of the letters (A) through (L) represents. Do not discuss adequacies or inadequacies in the system of internal control.

**N82**

**Number 3 (Estimated time — — 15 to 25 minutes)**

Trapan Retailing, Inc., has decided to diversify operations by selling through vending machines. Trapan's plans call for the purchase of 312 vending machines which will be situated at 78 different locations, within one city, and the rental of a warehouse to store merchandise. Trapan intends to sell only canned beverages at a standard price.

Management has hired an inventory control clerk to oversee the warehousing functions, and two truck drivers who will periodically fill the machines with merchandise, and deposit cash collected at a designated bank. Drivers will be required to report to the warehouse daily.

**Required:**

What internal controls should the auditor expect to find in order to assure the integrity of the cash receipts and warehousing functions?

**N81**

**Number 3 (Estimated time — — 15 to 25 minutes)**

Dunbar Camera Manufacturing, Inc., is a manufacturer of high-priced precision motion picture cameras in which the specifications of component parts are vital to the manufacturing process. Dunbar buys valuable camera lenses and large quantities of sheetmetal and screws. Screws and lenses are ordered by Dunbar and are billed by the vendors on a unit basis. Sheetmetal is ordered by Dunbar and is billed by the vendors on the basis of weight. The receiving clerk is responsible for documenting the quality and quantity of merchandise received.

A preliminary review of the system of internal control indicates that the following procedures are being followed:

**Receiving Report**

1. Properly approved purchase orders, which are prenumbered, are filed numerically. The copy sent to the receiving clerk is an exact duplicate of the copy sent to the vendor. Receipts of merchandise are recorded on the duplicate copy by the receiving clerk.

**Sheetmetal**

2. The company receives sheetmetal by railroad. The railroad independently weighs the sheetmetal and reports the weight and date of receipt on a bill of lading (waybill), which accompanies all deliveries. The receiving clerk only checks the weight on the waybill to the purchase order.

**Screws**

3. The receiving clerk opens cartons containing screws, then inspects and weighs the contents. The weight is converted to number of units by means of conversion charts. The receiving clerk then checks the computed quantity to the purchase order.

**Camera lenses**

4. Each camera lens is delivered in a separate corrugated carton. Cartons are counted as they are received by the receiving clerk and the number of cartons are checked to purchase orders.

**Required:**

a. Explain why the internal control procedures as they apply individually to receiving reports and the receipt of sheetmetal, screws, and camera lenses are adequate or inadequate. **Do not discuss recommendations for improvements.**

b. What financial statement distortions may arise because of the inadequacies in Dunbar's system of internal control and how may they occur?

**N80**

**Number 4 (Estimated time — — 15 to 25 minutes)**

The Art Appreciation Society operates a museum for the benefit and enjoyment of the community. During hours when the museum is open to the public, two clerks who are positioned at the entrance collect a five-dollar admission fee from each nonmember patron. Members of the Art Appreciation Society are permitted to enter free of charge upon presentation of their membership cards.

At the end of each day, one of the clerks delivers the proceeds to the treasurer. The treasurer counts the cash in the presence of the clerk and places it in a safe. Each Friday afternoon the treasurer and one of the clerks deliver all cash held in the safe to the bank, and receive an authenticated deposit slip which provides the basis for the weekly entry in the cash receipts journal.

The board of directors of the Art Appreciation Society has identified a need to improve their system of internal control over cash admission fees. The board has determined that the cost of installing turnstiles, sales booths or otherwise altering the physical layout of the museum will greatly exceed any benefits which may be derived. However, the board has agreed that the sale of admission tickets must be an integral part of its improvement efforts.

Smith has been asked by the board of directors of the Art Appreciation Society to review the internal control over cash admission fees and provide suggestions for improvement.

**Required:**

Indicate weaknesses in the existing system of internal control over cash admission fees, which Smith should identify, and recommend one improvement for each of the weaknesses identified.

Organize the answer as indicated in the following illustrative example:

<i>Weakness</i>	<i>Recommendation</i>
1. There is no basis for establishing the documentation of the number of paying patrons.	1. Prenumbered admission tickets should be issued upon payment of the admission fee.

M80  
Number 5 (cont.)

CROYDEN INC., FACTORY PAYROLL SYSTEM

FACTORY  
EMPLOYEES

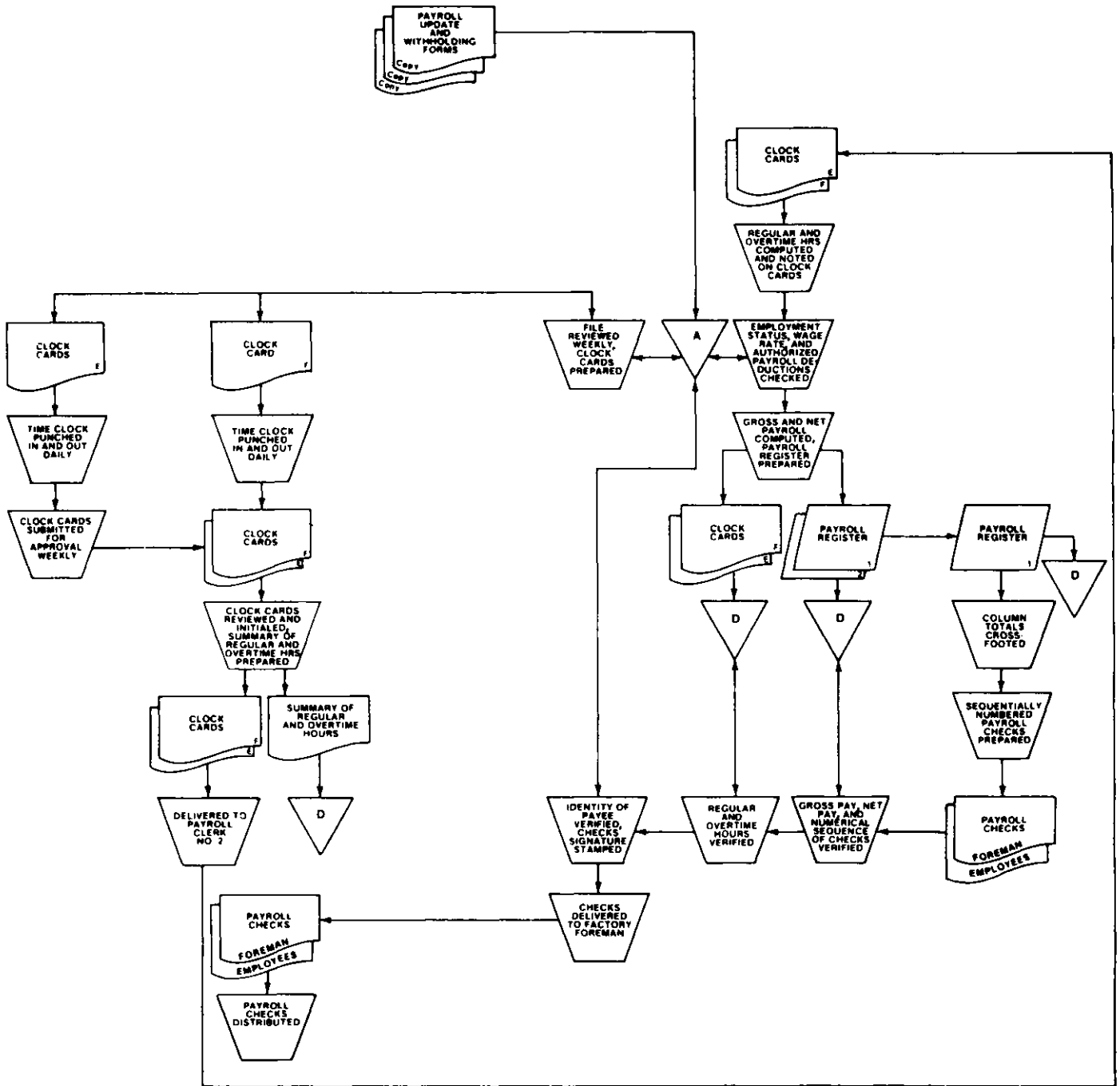
FACTORY  
FOREMAN

PERSONNEL

PAYROLL  
CLERK NO. 1

PAYROLL  
CLERK NO. 2

BOOKKEEPING



*Selected Questions*

**M80**

**Number 5 (Estimated time — — 15 to 25 minutes)**

A CPA's audit working papers contain a narrative description of a **segment** of the Croyden Factory, Inc. payroll system and an accompanying flowchart (p. 70) as follows:

**NARRATIVE**

The internal control system with respect to the personnel department is well-functioning and is **not** included in the accompanying flowchart.

At the beginning of each work week, payroll clerk No. 1 reviews the payroll department files to determine the employment status of factory employees and then prepares time cards and distributes them as each individual arrives at work. This payroll clerk, who is also responsible for custody of the signature stamp machine, verifies the identity of each payee before delivering signed checks to the foreman.

At the end of each work week, the foreman distributes payroll checks for the preceding work week. Concurrent with this activity, the foreman reviews the current week's employee time cards, notes the regular and overtime hours worked on a summary form, and initials the aforementioned time cards. The foreman then delivers all time cards and unclaimed payroll checks to payroll clerk No. 2.

**Required:**

**a.** Based upon the narrative and accompanying flowchart, what are the weaknesses in the system of internal control?

**b.** Based upon the narrative and accompanying flowchart, what inquiries should be made with respect to clarifying the existence of **possible additional weaknesses** in the system of internal control?

**Note:** Do not discuss the internal control system of the personnel department.

**D. Other Considerations**

**N82**

**Number 2 (Estimated time — — 15 to 25 minutes)**

Jiblum, CPA, is planning to use attribute sampling in order to determine the degree of reliance to be placed on an audit client's system of internal accounting control over sales. Jiblum has begun to develop an outline of the main steps in the sampling plan as follows:

1. State the objectives(s) of the audit test (e.g., to test the reliability of internal accounting controls over sales).

2. Define the population (define the period covered by the test; define the sampling unit; define the completeness of the population).

3. Define the sampling unit (e.g., client copies of sales invoices).

**Required:**

a. What are the remaining steps in the above outline which Jiblum should include in the statistical test of sales invoices? **Do not present a detailed analysis of tasks which must be performed to carry out the objectives of each step. Parenthetical examples need not be provided.**

b. How does statistical methodology help the auditor to develop a satisfactory sampling plan?



### III. Audit Evidence and Procedures

#### A. Audit Evidence

**N83**

**Number 4 (Estimated time — — 15 to 25 minutes)**

Taylor, CPA, is engaged in the audit of Rex Wholesaling for the year ended December 31, 1982. Taylor performed a proper study of the system of internal accounting control relating to the purchasing, receiving, trade accounts payable, and cash disbursement cycles and has decided not to proceed with compliance testing. Based upon analytical review procedures, Taylor believes that the trade accounts payable balance on the balance sheet as of December 31, 1982, may be understated.

Taylor requested and obtained a client-prepared trade accounts payable schedule listing the total amount owed to each vendor.

**Required:**

What additional substantive audit procedures should Taylor apply in examining the trade accounts payable?

**N83**

**Number 5 (Estimated time — — 15 to 25 minutes)**

Kent, CPA, who is engaged in the audit of the financial statements of Bass Corporation for the year ended December 31, 1982, is about to commence an audit of the noncurrent investment securities. Bass's records indicate that the company owns various bearer bonds, as well as 25% of the outstanding common stock of Commercial Industrial Inc. Kent is satisfied with evidence that supports the presumption of significant influence over Commercial Industrial Inc. The various securities are at two locations, as follows:

- Recently acquired securities are in the company's safe in the custody of the treasurer.
- All other securities are in the company's bank safe deposit box.

All of the securities in Bass's portfolio are actively traded in a broad market.

**Required:**

a. Assuming that the system of internal control over securities is satisfactory and may be relied upon, what are the objectives of the examination of these noncurrent investment securities?

b. What audit procedures should be undertaken by Kent with respect to the examination of Bass's non-current investment securities?

**M83**

**Number 2 (Estimated time — — 15 to 25 minutes)**

During the examination of the annual financial statements of Amis Manufacturing, Inc., the company's president, R. Alderman, and Luddy, the auditor, reviewed matters that were supposed to be included in a written representation letter. Upon receipt of the following client representation letter, Luddy contacted Alderman to state that it was incomplete.

To E. K. Luddy, CPA

In connection with your examination of the balance sheet of Amis Manufacturing, Inc. as of December 31, 1982, and the related statements of income, retained earnings, and changes in financial position for the year then ended, for the purpose of expressing an opinion as to whether the financial statements present fairly the financial position, results of operations, and changes in financial position of Amis Manufacturing, Inc. in con-

*Auditing*

formity with generally accepted accounting principles, we confirm, to the best of our knowledge and belief, the following representations made to you during your examination. There were no:

- Plans or intentions that may materially affect the carrying value or classification of assets and liabilities.
- Communications from regulatory agencies concerning noncompliance with, or deficiencies in, financial reporting practices.
- Agreements to repurchase assets previously sold.
- Violations or possible violations of laws or regulations whose effects should be considered for disclosure in the financial statements or as a basis for recording a loss contingency.
- Unasserted claims or assessments that our lawyer has advised are probable of assertion and must be disclosed in accordance with Statement of Financial Accounting Standards No. 5.
- Capital stock repurchase options or agreements or capital stock reserved for options, warrants, conversions, or other requirements.
- Compensating balance or other arrangements involving restrictions on cash balances.

R. Alderman, President  
Amis Manufacturing, Inc.

March 14, 1983

**Required:**

Identify the other matters that Alderman's representation letter should specifically confirm.

**M83**

**Number 4 (Estimated time — — 15 to 25 minutes)**

The following client-prepared bank reconciliation is being examined by Kautz, CPA, during an examination of the financial statements of Cynthia Company:

*Cynthia Company*  
**BANK RECONCILIATION**  
**VILLAGE BANK ACCOUNT 2**  
*December 31, 1982*

Balance per bank (a)		\$18,375.91
Deposits in Transit (b)		
12/30	\$1,471.10	
12/31	<u>2,840.69</u>	<u>4,311.79</u>
Subtotal		22,687.70
Outstanding checks (c)		
837	6,000.00	
1941	671.80	
1966	320.00	
1984	1,855.42	
1985	3,621.22	
1987	2,576.89	
1991	<u>4,420.88</u>	<u>(19,466.21)</u>
Subtotal		3,221.49
NSF check returned		
12/29 (d)		200.00
Bank charges		5.50
Error Check No. 1932		148.10
Customer note collected		
by the bank (\$2,750 plus		
\$275 interest) (e)		<u>( 3,025.00)</u>
Balance per books (f)		<u><u>\$ 550.09</u></u>

**Required:**

Indicate one or more audit procedures that should be performed by Kautz in gathering evidence in support of each of the items (a) through (f) above.

**N82**

**Number 4 (Estimated time — — 15 to 25 minutes)**

Andrews, CPA, has been engaged to examine the financial statements of Broadwall Corporation for the year ended December 31, 1981. During the year, Broadwall obtained a long-term loan from a local bank pursuant to a financing agreement which provided that the:

1. Loan was to be secured by the company's inventory and accounts receivable.
2. Company was to maintain a debt to equity ratio not to exceed two to one.
3. Company was not to pay dividends without permission from the bank.
4. Monthly installment payments were to commence July 1, 1981.

In addition, during the year the company also borrowed, on a short-term basis, from the president of the company, including substantial amounts just prior to the year end.

**Required:**

- a. For purposes of Andrews's audit of the financial statements of Broadwall Corporation, what procedures should Andrews employ in examining the described loans? **Do not discuss internal control.**
- b. What are the financial statement disclosures that Andrews should expect to find with respect to the loans from the president?

**M82**

**Number 2 (Estimated time — — 15 to 25 minutes)**

During the year, Strang Corporation began to encounter cash flow difficulties, and a cursory review by management revealed receivable collection problems. Strang's management engaged Stanley, CPA, to perform a special investigation. Stanley studied the billing and collection cycle and noted the following:

The accounting department employs one bookkeeper who receives and opens all incoming mail. This bookkeeper is also responsible for depositing receipts, filing remittance advices on a daily basis, recording receipts in the cash receipts journal, and posting receipts in the individual customer accounts and the general ledger accounts. There are no cash sales. The bookkeeper prepares and controls the mailing of monthly statements to customers.

The concentration of functions and the receivable collection problems caused Stanley to suspect that a systematic defalcation of customers' payments through a delayed posting of remittances (lapping of accounts receivable) is present. Stanley was surprised to find that no customers complained about receiving erroneous monthly statements.

**Required:**

Identify the procedures which Stanley should perform to determine whether lapping exists. **Do not discuss deficiencies in the system of internal control.**

**N81**

**Number 2 (Estimated time — — 15 to 25 minutes)**

During an examination of the financial statements of Gole Inc., Robbins, CPA, requested and received a client-prepared property casualty insurance schedule which included appropriate premium information.

**Required:**

- a. Identify the type of information, in addition to the appropriate premium information, that would ordinarily be expected to be included in a property casualty insurance schedule.
- b. What are the basic audit procedures which Robbins should perform in examining the client-prepared property casualty insurance schedule?

**M81**

**Number 5 (Estimated time — — 15 to 25 minutes)**

Decker, CPA, is performing an examination of the financial statements of Allright Wholesale Sales, Inc., for the year ended December 31, 1980. Allright has been in business for many years and has never had its financial statements audited. Decker has gained satisfaction with respect to the ending inventory and is considering alternative audit procedures to gain satisfaction with respect to management's representations concerning the beginning inventory which was not observed.

Allright sells only one product (bottled brand X beer), and maintains perpetual inventory records. In addition, Allright takes physical inventory counts monthly. Decker has already confirmed purchases with the manufacturer and has decided to concentrate on evaluating the reliability of perpetual inventory records and performing analytical review procedures to the extent that prior years' unaudited records will enable such procedures to be performed.

**Required:**

What are the audit tests, including analytical review procedures, which Decker should apply in evaluating the reliability of perpetual inventory records and gaining satisfaction with respect to the January 1, 1980 inventory?

**M80**

**Number 4 (Estimated time — — 15 to 25 minutes)**

Analytical review procedures are substantive tests which are extremely useful in the initial audit planning stage.

**Required:**

- a. Explain why analytical review procedures are considered substantive tests.
- b. Explain how analytical review procedures may be useful in the initial audit planning stage.
- c. Identify the analytical review procedures which one might expect a CPA to utilize during an examination performed in accordance with generally accepted auditing standards.

**B. Specific Audit Objectives and Procedures**

**N84**

**Number 2 (Estimated time — — 15 to 25 minutes)**

Pierce, an independent auditor, was engaged to examine the financial statements of Mayfair Construction Incorporated for the year ended December 31, 1983. Mayfair's financial statements reflect a substantial amount of mobile construction equipment used in the firm's operations. The equipment is accounted for in a subsidiary ledger. Pierce performed a study and evaluation of internal accounting control and found it satisfactory.

**Required:**

Identify the substantive audit procedures which Pierce should utilize in examining mobile construction equipment and related depreciation in Mayfair's financial statements.

**M84**

**Number 5 (Estimated time 15 — — 25 minutes)**

Finney, CPA, was engaged to conduct an audit of the financial statements of Clayton Realty Corporation for the month ending January 31, 1984. The examination of monthly rent reconciliations is a vital portion of the audit engagement.

The following rent reconciliation was prepared by the controller of Clayton Realty Corporation and was presented to Finney who subjected it to various audit procedures:

*Clayton Realty Corporation*  
**RENT RECONCILIATION**  
*For the month ended*  
*January 31, 1984*

Gross apartment rents (Schedule A)	\$1,600,800*
Less vacancies (Schedule B)	<u>20,500*</u>
Net apartment rentals	1,580,300
Less unpaid January rents (Schedule C)	<u>7,800*</u>
Total	1,572,500
Add prepaid rent collected (Apartment 116)	<u>500*</u>
Total cash collected	<u><u>\$1,573,000*</u></u>

Schedules A, B, and C are available to Finney but have not been illustrated. Finney has conducted a study and evaluation of the system of internal control and found that it could be relied upon to produce reliable accounting information. Cash receipts from rental operations are deposited in a special bank account.

**Required:**

What substantive audit procedures should Finney employ during the audit in order to substantiate the validity of each of the dollar amounts marked by an asterisk (\*)?

Selected Questions

**M82**

**Number 4 (Estimated time — — 15 to 25 minutes)**

The following schedule was prepared by the controller of World Manufacturing Inc., for use by the independent auditors during their examination of World's year-end financial statements. All procedures performed by the audit assistant were noted at the bottom "Legend" section, and it was properly initialed, dated and indexed, and then submitted to a senior member of the audit staff for review. Internal control was reviewed and is considered to be satisfactory.

*World Manufacturing, Inc.*  
**MARKETABLE SECURITIES**  
*Year Ended December 31, 1981*

Description of Security	Serial No.	Face value of bonds	Gen. ledger 1/1	Purch. in 1981	Sold in 1981	Cost	Gen. ledger 12/31	12/31 market	Dividend & Interest			
									Pay date(s)	Amt. rec.	Accruals 12/31	
<b>Corp. Bonds</b>	<b>%</b>	<b>Yr. Due</b>										
A	6	91	21-7	10000	9400a		9400	9100	1/15	300 b,d		
D	4	83	73-0	30000	27500a		27500	26220	7/15	300 b,d	275	
G	9	98	16-4	5000	4000a		4000	5080	12/1	1200 b,d	100	
Rc	5	85	08-2	70000	66000a	57000b	66000		8/1	450 b,d	188	
Sc	10	99	07-4	100000		100000e	100000	101250	7/1	5000 b,d	5000	
				<u>106900</u>	<u>100000</u>	<u>57000</u>	<u>66000</u>	<u>140900</u>	<u>141650</u>		<u>7250</u>	<u>5563</u>
				a,f	f	f	f	f,g	f	f	f	
<b>Stocks</b>												
P 1,000 shs. Common			1044		7500a		7500	7600	3/1	750 b,d		
									6/1	750 b,d		
									9/1	750 b,d		
									12/1	750 b,d	250	
U 50 shs. Common			8530		9700a		9700	9800	2/1	800 b,d		
									8/1	800 b,d	667	
				<u>17200</u>			<u>17200</u>	<u>17400</u>		<u>4600</u>	<u>917</u>	
				a,f			f,g	f		f	f	

Legends and comments relative to above

- a = Beginning balances agreed to 1980 working papers
- b = Traced to cash receipts
- c = Minutes examined (purchase and sales approved by the board of directors)
- d = Agreed to 1099
- e = Confirmed by tracing to broker's advice
- f = Totals footed
- g = Agreed to general ledger

**Required:**

- a. What information that is essential to the audit of marketable securities is missing from this schedule?
- b. What are the essential audit procedures that were not noted as having been performed by the audit assistant?

Auditing

N80

Number 5 (Estimated time — — 15 to 25 minutes)

James, who was engaged to examine the financial statements of Talbert Corporation, is about to audit payroll. Talbert uses a computer service center to process weekly payroll as follows:

Each Monday Talbert's payroll clerk inserts data in appropriate spaces on the preprinted service center prepared input form, and sends it to the service center via messenger. The service center extracts new permanent data from the input form and updates master files. The weekly payroll data are then processed. The weekly payroll register and payroll checks are printed and delivered by messenger to Talbert on Thursday.

Part of the sample selected for audit by James includes the following input form and payroll register:

**Talbert Corporation Payroll Input — Week Ending Friday, Nov. 23, 1979**

— Employee Data — Permanent File —				— Current Week's Payroll Data —					
Name	Social Security	W-4 Information	Hourly Rate	Hours		Special Deductions			
				Reg	OT	Bonds	Union	Other	
A. Bell	999-99-9991	M-1	10.00	35	5	18.75			
B. Carr	999-99-9992	M-2	10.00	35	4				
C. Dawn	999-99-9993	S-1	10.00	35	6	18.75	4.00		
D. Ellis	999-99-9994	S-1	10.00	35	2		4.00	50.00	
E. Frank	999-99-9995	M-4	10.00	35	1		4.00		
F. Gillis	999-99-9996	M-4	10.00	35			4.00		
G. Hugh	999-99-9997	M-1	7.00	35	2	18.75	4.00		
H. Jones	999-99-9998	M-2	7.00	35			4.00	25.00	
J. King	999-99-9999	S-1	7.00	35	4		4.00		
<i>New Employee</i>									
J. Smith	999-99-9990	M-3	7.00	35					

**Talbert Corporation Payroll Register — Nov. 23, 1979**

Employee	Social Security	Hours		Payroll		Gross Payroll	Taxes Withheld			Other Withheld	Net Pay	Check No.
		Reg	OT	Regular	OT		FICA	Fed	State			
A. Bell	999-99-9991	35	5	350.00	75.00	425.00	26.05	76.00	27.40	18.75	276.80	1499
B. Carr	999-99-9992	35	4	350.00	60.00	410.00	25.13	65.00	23.60		296.27	1500
C. Dawn	999-99-9993	35	6	350.00	90.00	440.00	26.97	100.90	28.60	22.75	260.78	1501
D. Ellis	999-99-9994	35	2	350.00	30.00	380.00	23.29	80.50	21.70	54.00	200.51	1502
E. Frank	999-99-9995	35	1	350.00	15.00	365.00	22.37	43.50	15.90	4.00	279.23	1503
F. Gillis	999-99-9996	35		350.00		350.00	21.46	41.40	15.00	4.00	268.14	1504
G. Hugh	999-99-9997	35	2	245.00	21.00	266.00	16.31	34.80	10.90	22.75	181.24	1505
H. Jones	999-99-9998	35		245.00		245.00	15.02	26.40	8.70	29.00	165.88	1506
J. King	999-99-9999	35	4	245.00	42.00	287.00	17.59	49.40	12.20	4.00	203.81	1507
J. Smith	999-99-9990	35		245.00		245.00	15.02	23.00	7.80		199.18	1508
Totals		350	24	3,080.00	333.00	3,413.00	209.21	540.90	171.80	159.25	2,331.84	

**Required:**

- a. Describe how James should verify the information in the payroll input form shown above.
- b. Describe (but do **not** perform) the procedures that James should follow in the examination of the November 23, 1979, payroll register shown above.

### C. Other Specific Topics

**M81**

**Number 2 (Estimated time — 15 to 25 minutes)**

Windek, a CPA, is nearing the completion of an examination of the financial statements of Jubilee, Inc., for the year ended December 31, 1980. Windek is currently concerned with ascertaining the occurrence of subsequent events that may require adjustment or disclosure essential to a fair presentation in conformity with generally accepted accounting principles.

**Required:**

- a. Briefly explain what is meant by the phrase "subsequent events."
- b. How do those subsequent events which require financial statement adjustment differ from those that require financial statement disclosure?
- c. What are the procedures which should be performed in order to ascertain the occurrence of subsequent events?

**M80**

**Number 3 (Estimated time — 15 to 25 minutes)**

After determining that computer controls are valid, Hastings is reviewing the sales system of Rosco Corporation in order to determine how a computerized

audit program may be used to assist in performing tests of Rosco's sales records.

Rosco sells crude oil from one central location. All orders are received by mail and indicate the pre-assigned customer identification number, desired quantity, proposed delivery date, method of payment, and shipping terms. Since price fluctuates daily, orders do not indicate a price. Price sheets are printed daily and details are stored in a permanent disc file. The details of orders are also maintained in a permanent disc file.

Each morning the shipping clerk receives a computer printout which indicates details of customers' orders to be shipped that day. After the orders have been shipped, the shipping details are inputted in the computer which simultaneously updates the sales journal, perpetual inventory records, accounts receivable, and sales accounts.

The details of all transactions, as well as daily updates, are maintained on discs which are available for use by Hastings in the performance of the audit.

**Required:**

- a. How may a computerized audit program be used by Hastings to perform substantive tests of Rosco's sales records in their machine-readable form? **Do not discuss accounts receivable and inventory.**
- b. After having performed these tests with the assistance of the computer, what other auditing procedures should Hastings perform in order to complete the examination of Rosco's sales records?

## IV. Reporting

### A. Reporting Standards and Types of Reports

**N84**

**Number 5 (Estimated time 15 — 25 minutes)**

Devon Incorporated engaged Smith to examine its financial statements for the year ended December 31, 1983. The financial statements of Devon Incorporated for the year ended December 31, 1982, were examined by Jones whose March 31, 1983, auditor's report expressed an unqualified opinion. This report of Jones is not presented with the 1983-1982 comparative financial statements.

Smith's working papers contain the following information that does not appear in footnotes to the 1983 financial statements as prepared by Devon Incorporated:

- One director appointed in 1983 was formerly a partner in Jones's accounting firm. Jones's firm provided financial consulting services to Devon during 1979 and 1978, for which Devon paid approximately \$1,600 and \$9,000, respectively.
- The company refused to capitalize certain lease obligations for equipment acquired in 1983. Capitalization of the leases in conformity with generally accepted accounting principles would have increased assets and liabilities by \$312,000 and \$387,000, respectively, and decreased retained earnings as of December 31, 1983, by \$75,000, and would have decreased net income and earnings per share by \$75,000 and \$.75, respectively, for the year then ended. Smith has concluded that the leases should have been capitalized.
- During the year, Devon changed its method of valuing inventory from the first-in, first-out method to the last-in, first-out method. This change was made because management believes LIFO more clearly reflects net income by providing a closer matching of current costs and current revenues. The change had the effect of reducing inventory at December 31, 1983 by \$65,000 and net income and earnings per share by \$38,000 and \$.38, respectively, for the year then ended. The effect of the change on prior years was immaterial;

## Auditing

accordingly, there was no cumulative effect of the change. Smith firmly supports the company's position.

After completion of the field work on February 29, 1984, Smith concludes that the expression of an adverse opinion is not warranted.

### Required

Prepare the body of Smith's report dated February 29, 1984, and addressed to the Board of Directors to accompany the 1983-1982 comparative financial statements.

### M84

**Number 2 (Estimated time — — 15 to 25 minutes)**

Young and Young, CPAs, completed an examination of the financial statements of XYZ Company, Inc., for the year ended June 30, 1983, and issued a standard unqualified auditor's report dated August 15, 1983. At the time of the engagement the Board of Directors of XYZ requested a special report attesting to the adequacy of the provision for federal and state income taxes and the related accruals and deferred income taxes as presented in the June 30, 1983, financial statements.

Young and Young submitted the appropriate special report on August 22, 1983.

### Required:

Prepare the special report that Young and Young should have submitted to XYZ Company, Inc.

### N83

**Number 3 (Estimated time — — 15 to 25 minutes)**

Ross, Sandler & Co., CPAs, completed an examination of the 1982 financial statements of Fairfax Corporation on March 17, 1983, and concluded that an unqualified opinion was warranted. Because of a scope limitation arising from the inability to observe the January 1, 1981 inventory, the predecessor auditors, Smith, Ellis & Co., issued a report which contained an unqualified opinion on the December 31, 1981 balance sheet and a qualified opinion with respect to the statements of income, retained earnings, and changes in financial position for the year then ended.

The management of Fairfax Corporation has decided to present a complete set of comparative (1982 and 1981) financial statements in their annual report.

### Required:

Prepare an auditor's report assuming the March 1, 1982 auditor's report of Smith, Ellis & Co. is not presented.

### M83

**Number 3 (Estimated time — — 15 to 25 minutes)**

The following report was drafted by an audit assistant at the completion of an audit engagement and was submitted to the auditor with client responsibility for review. The auditor has reviewed matters thoroughly and has properly concluded that the scope limitation was not client-imposed and was not sufficiently material to warrant a disclaimer of opinion although a qualified opinion was appropriate.

To Carl Corporation Controller:

We have examined the accompanying financial statements of Carl Corporation as of December 31, 1982. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such auditing procedures as we considered necessary in the circumstances.

On January 15, 1983, the company issued debentures in the amount of \$1,000,000 for the purpose of financing plant expansion. As indicated in note 6 to the financial statements, the debenture agreement restricts the payment of future cash dividends to earnings after December 31, 1982.

The company's unconsolidated foreign subsidiary did not close down production during the year under examination for physical inventory purposes and took no physical inventory during the year. We made extensive tests of book inventory figures for accuracy of calculation and reasonableness of pricing. We did not make physical tests of inventory quantities. Because of this, we are unable to express an unqualified opinion on the financial statements taken as a whole. However, except for the scope limitation regarding inventory, in our opinion the accompanying balance sheet presents the financial position of Carl Corporation at December 31, 1982, subject to the effect of the inventory on the carrying value of the investment. The accompanying statements of income and of retained earnings present the incomes and expenses and the result of transactions affecting retained earnings in accordance with generally accepted accounting principles.

December 31, 1982

Pate & Co., CPAs

### Required:

Identify all of the deficiencies in the above draft of the proposed report.

### N82

**Number 5 (Estimated time — — 15 to 25 minutes)**

For the year ended December 31, 1980, Novak & Co., CPAs, audited the financial statements of Tillis Ltd., and expressed an unqualified opinion dated February 27, 1981.

For the year ended December 31, 1981, Novak & Co. were engaged by Tillis Ltd. to review Tillis Ltd.'s



## Selected Questions

financial statements, i.e., “look into the company’s financial statements and determine whether there are any obvious modifications that should be made to the financial statements in order for them to be in conformity with generally accepted accounting principles.”

Novak made the necessary inquiries, performed the necessary analytical procedures, and performed certain additional procedures that were deemed necessary to achieve the requisite limited assurance. Novak’s work was completed on March 3, 1982, and the financial statements appeared to be in conformity with generally accepted accounting principles which were consistently applied. The report was prepared on March 5, 1982. It was delivered to Jones, the controller of Tillis Ltd., on March 9, 1982.

### Required:

Prepare the properly addressed and dated report on the comparative financial statements of Tillis Ltd., for the years ended December 31, 1980 and 1981.

### M82

**Number 5 (Estimated time — — 15 to 25 minutes)**

In order to obtain information that is necessary to make informed decisions, management often calls upon the independent auditor for assistance. This may involve a request that the independent auditor apply certain audit procedures to specific accounts of a company which is a candidate for acquisition and report upon the results. In such an engagement, the agreed-upon procedures may constitute a scope limitation.

At the completion of an engagement performed at the request of Uclean Corporation which was limited in scope as explained above, the following report was prepared by an audit assistant and was submitted to the auditor for review:

To: Board of Directors of Ajax Corporation

We have applied certain agreed-upon procedures, as discussed below, to accounting records of Ajax Corporation, as of December 31, 1981, solely to assist Uclean Corporation in connection with the proposed acquisition of Ajax Corporation.

We have examined the cash in banks and accounts receivable of Ajax Corporation as of December 31, 1981, in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the cash and receivables referred to above are fairly presented as of December 31, 1981, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year. We therefore recommend that Uclean Corporation acquire Ajax Corporation pursuant to the proposed agreement.

Signature

### Required:

Comment on the proposed report describing those assertions that are:

- Incorrect or should otherwise be deleted.
- Missing and should be inserted.

### N81

**Number 5 (Estimated time — — 15 to 25 minutes)**

Sturdy Corporation owns and operates a large office building in a desirable section of New York City’s financial center. For many years the management of Sturdy Corporation has modified the presentation of their financial statements by:

- Reflecting a write-up to appraisal values in the building accounts.
- Accounting for depreciation expense on the basis of such valuations.

Wyley, a successor CPA, was asked to examine the financial statements of Sturdy Corporation, for the year ended December 31, 1980. After completing the examination, Wyley concluded that, consistent with prior years, an adverse opinion would have to be expressed because of the materiality of the apparent deviation from the historical-cost principle.

### Required:

a. Describe in detail the form of presentation of the middle paragraph of the auditor’s report on the financial statements of Sturdy Corporation for the year ended December 31, 1980, clearly identifying the information contained in the paragraph. Do not discuss deferred taxes.

b. Write a draft of the opinion paragraph of the auditor’s report on the financial statements of Sturdy Corporation for the year ended December 31, 1980.

### M81

**Number 3 (Estimated time — — 15 to 25 minutes)**

The following tentative auditor’s report was drafted by a staff accountant and submitted to a partner in the accounting firm of Better & Best, CPAs:

To the Audit Committee of  
American Widgets, Inc.

We have examined the consolidated balance sheets of American Widgets, Inc., and subsidiaries as of December 31, 1980, and 1979, and the related consolidated statements of income, retained earnings, and changes in financial position, for the years then ended. Our examinations were made in accordance with generally accepted auditing standards as we considered necessary in the circumstances. Other auditors examined the financial statements of certain subsidiaries and have furnished us with reports thereon containing no exceptions. Our opinion expressed herein, insofar as it relates to the amounts included for those subsidiaries, is based solely upon the reports of the other auditors.

As discussed in Note 4 to the financial statements, on January 8, 1981, the company halted the production of certain medical equipment as a result of inquiries by the Food and Drug Administration, which raised questions as to the adequacy of some of the company's sterilization equipment and related procedures. Management is not in a position to evaluate the effect of this production halt and the ensuing litigation, which may have an adverse effect on the financial position of American Widgets, Inc.

As fully discussed in Note 7 to the financial statements, in 1980 the company extended the use of the last-in, first-out (LIFO) method of accounting to include all inventories. In examining inventories, we engaged Dr. Irwin Same (Nobel Prize winner 1978) to test check the technical requirements and specifications of certain items of equipment manufactured by the company.

In our opinion, except for the effects, if any, on the financial statements of the ultimate resolution of the matter discussed in the second preceding paragraph, the financial statements referred to above present fairly the financial position of American Widgets, Inc., as of December 31, 1980, and the results of operations for the years then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

To be signed by  
Better & Best, CPAs

March 1, 1981 except  
for Note 4 as to which  
the date is January 8, 1981

**Required:**

Identify deficiencies in the staff accountant's tentative report which constitute departures from the generally accepted standards of reporting. **Do not consider any AICPA exposure drafts that are currently outstanding.**

**N80**

**Number 2 (Estimated time — — 15 to 25 minutes)**

Rose & Co., CPAs, has satisfactorily completed the examination of the financial statements of Bale & Booster, a partnership, for the year ended December 31, 1979. The financial statements which were prepared on the entity's income tax (cash) basis include footnotes which indicate that the partnership was involved in continuing litigation of material amounts relating to alleged infringement of a competitor's patent. The amount of damages, if any, resulting from this litigation could not be determined at the time of completion of the engagement. The prior years' financial statements were not presented.

**Required:**

Based upon the information presented, prepare an auditor's report which includes appropriate explanatory disclosure of significant facts.

**N80**

**Number 3 (Estimated time — — 15 to 25 minutes)**

The auditor should obtain a level of knowledge of the entity's business, including events, transactions, and practices, that will enable the planning and performance of an examination in accordance with generally accepted auditing standards. Adhering to these standards enables the auditor's report to lend credibility to financial statements by providing the public with certain assurances.

**Required**

a. How does knowledge of the entity's business help the auditor in the planning and performance of an examination in accordance with generally accepted auditing standards?

b. What assurances are provided to the public when the auditor states that the financial statements "present fairly ... in conformity with generally accepted accounting principles applied on a consistent basis"?

## SELECTED ESSAYS — UNOFFICIAL ANSWERS

### I. Professional Responsibilities

**M84**

**Answer 3** (10 points)

a. Prior to acceptance of the engagement, Tish & Field should have communicated with the predecessor auditor regarding —

- Facts that might bear on the integrity of management.
- Disagreements with management concerning accounting principles, auditing procedures, or other significant matters.
- The predecessor's understanding about the reason for the change.
- Any other information that may be of assistance in determining whether to accept the engagement.

b. The form and content of engagement letters may vary, but they would generally contain information regarding —

- The objective of the audit.
- The estimated completion date.
- Management's responsibility for the financial statements.
- The scope of the audit.
- Other communication of the results of the engagement.
- The fact that because of the test nature and other inherent limitations of an audit, together with the inherent limitations of any system of internal control, there is an unavoidable risk that even some material misstatement may remain undiscovered.
- Access to whatever records, documentation, and other information may be requested in connection with the audit.
- Arrangements with respect to client assistance in the performance of the audit engagement.
- Expectation of receiving from management written confirmation concerning representations made in connection with the audit.

- Notification of any changes in the original arrangements that might be necessitated by unknown or unforeseen factors.
- Request for the client to confirm the terms of the engagement by acknowledging receipt of the engagement letter.
- The basis on which fees are computed and any billing arrangements.

**M80**

**Answer 2** (10 points)

a.

Services That Savage  
May Perform

Services That Savage  
May Not Perform

- Counsel on potential expansion plans.
  - Search for and interview new personnel.
  - Train personnel.
  - Hire new personnel.
  - Supervise the operation of the system.
  - Monitor client-prepared source documents and make changes in basic EDP generated data without concurrence of the client.
- b. The significant matters related to an engagement generally include (a) the engagement's objectives, (b) the scope, (c) the approach, (d) the role of all personnel, (e) the manner in which results are to be communicated, (f) the timetable, and (g) the fee.
- c. Savage must be qualified to supervise and evaluate the work of specialist employees. Although supervision does not require that Savage be qualified to perform each of the specialist's tasks, Savage should be able to define the tasks and evaluate the end product.

## II. Internal Control

### A. Definitions and Basic Concepts

**M82**

**Answer 3** (10 points)

a. Accounting control comprises the plan of organization and the procedures and records that are concerned with the safeguarding of assets and the reliability of financial records.

b. A system of accounting control is designed to provide reasonable assurance that—

- Transactions are executed in accordance with management's general or specific authorization.
- Transactions are recorded as necessary (1) to permit preparation of financial statements in conformity with generally accepted accounting principles or any other criteria applicable to such statements and (2) to maintain accountability for assets.
- Access to assets is permitted only in accordance with management's authorization.
- The recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences.

c. There are inherent limitations that should be recognized in considering the potential effectiveness of any system of accounting control. In the performance of most control procedures there are possibilities for errors arising from such causes as misunderstanding of instructions, mistakes of judgment, and personal carelessness, distraction, or fatigue. Furthermore, procedures whose effectiveness depends on segregation of duties obviously can be circumvented by collusion. Similarly, procedures designed to assure the execution and recording of transactions in accordance with management's authorizations may be ineffective against either errors or irregularities perpetrated by management with respect to transactions or to the estimates and judgments required in the preparation of financial statements. In addition to the limitations discussed above, any projection of a current evaluation of internal accounting control to future periods is subject to the risk that the procedures may become inadequate because of changes in conditions and that the degree of compliance with the procedures may deteriorate.

**N81**

**Answer 4** (10 points)

a. The primary internal control objectives in separating the programming and operating functions are

achieved by preventing programmer access to the computer (except during designated testing periods) or to input or output documents and by preventing operator access to operating programs and operating program documentation, or by preventing operators from writing or changing programs.

b. Johnson is likely to find the following mitigating controls that are particularly important and that should exist when the programming and operating functions are not separated:

- Joint operation by two or more operators
- Rotation of operator duties
- Use of a computer activity log book
- Comparison of computer times to an average or norm
- Investigation of all excess computer time (errors)
- Adequate supervision of all EDP operations
- Periodic comparison of program code value to a control value
- Periodic comparison of all programs with control copies
- Required vacations for all employees

### B. Study and Evaluation of the System

**N84**

**Answer 3** (10 points)

The auditor's internal control questionnaire should include the following additional questions:

- Does access to the bank safe deposit vault require the signature or presence of two designated persons?
- Are all individuals who have access to marketable securities bonded?
- Are those who have access to the securities denied access to the accounting records?
- Does the accounting department keep detailed records of —
  - Purchases and sales?
  - Securities (including number of shares) owned?
  - Stock certificate numbers?
  - Dividend income?
  - Gains and losses?
- Are all securities registered in the name of the company?
- Are all securities periodically inspected?
- Is the inspection performed on a surprise basis?

*Unofficial Answers*

- Is the physical inventory of securities reconciled with the accounting records?
- Are all purchases and sales of securities executed by the treasurer within the directives of the investment committee?
- Is the amount of dividends received on individual investments periodically reconciled to published public records?
- Does the investment committee periodically review compliance with its established policy?

**M81**

**Answer 4** (10 points)

*University Books Incorporated*  
**REVOLVING CASH FUND**  
**INTERNAL CONTROL QUESTIONNAIRE**

<u>Question</u>	<u>Yes</u>	<u>No</u>
Is responsibility for the fund vested in one person?		
Is physical access to the fund denied to all others?		
Is the custodian independent of other employees who handle cash?		
Is the custodian bonded?		
Is the custodian denied access to other cash funds?		
Are receipts unalterable?		
Are receipts prenumbered?		
Is the integrity of the prenumbered sequence periodically accounted for?		
Does the seller sign receipts?		
Are receipts attached to reimbursement vouchers?		
Are vouchers that are submitted for reimbursement approved by someone other than the custodian?		
Are reimbursement vouchers and attachments (receipts) cancelled after reimbursement?		
Is the fund used exclusively for the acquisition of books?		
Is the fund periodically counted and reconciled by someone other than the custodian?		
Is the fund maintained on an imprest basis?		
Is the size of the fund appropriate for the purpose intended?		

**C. Cycles**

**N84**

**Answer 4** (10 points)

Letters "B" through "P" indicate:

- B. Credit Department
- C. Shipping Department
- D. Billing Department
- E. Accounts Receivable Department
- F. File pending availability of merchandise for shipment.
- G. Prepare three-part sales invoice
- H. Three-part sales invoice
- I. Record in sales journal
- J. Sales invoice - copy 3 (J and K are interchangeable)
- K. Approved sales order - copy 3 (J and K are interchangeable)
- L. Bill of lading - copy 2
- M. Customer purchase order
- N. Sales order - copy 1
- O. File by customer name or customer number
- P. Accounts receivable ledger

**M84**

**Answer 4** (10 points)

The following edit checks might be used to detect errors during the typing of answers to the input cues:

- Password — ensures that the operator is authorized to access computer programs and files.
- Numeric check — ensures that numbers are entered into and accepted by the system where only numbers are required to be entered, e.g., numbers 0-9 in social security number.
- Alphabetic check — ensures that letters are entered into and accepted by the system where only letters are required to be entered, e.g., letters A-Z in employee name.
- Special-character check — ensures that only specific special characters are entered into and accepted by the system where only these special characters are required to be entered, e.g., dashes between numbers in social security number.
- Sign check — ensures that positive or negative signs are entered into and accepted by the system where only such signs are required to be entered or that the absence of a positive or negative sign appears where such an absence is required, e.g., hours worked.
- Arithmetic check — ensures the validity of the result of a mathematical computation, e.g., total employees for period equals number of employee numbers in system.
- Validity check — ensures that only authorized data codes will be entered into and accepted by the system where only such authorized data codes are required, e.g., authorized employee account numbers.
- Limit (reasonableness) check — ensures that only data within predetermined limits will be entered into and accepted by the system, e.g., rate per hour cannot be lower than the minimum set by law or higher than the maximum set by management.
- Self-checking digit — ensures that only specific code numbers prepared by using a specific arithmetic op-

## Auditing

eration will be entered into and accepted by the system, e.g., employee numbers generated by the modulus 11 method with prime-number weighting.

- Size check — ensures that only data using fixed or defined field lengths will be entered into and accepted by the system, e.g., number of dependents require exactly two digits.
- Missing-data check — ensures that no blanks will be entered into and accepted by the system when data should be present, e.g., an “S” or “M” is entered in response to *single?* or *married?*
- Overflow check — ensures that no digits are dropped if a number becomes too large for a variable during processing, e.g., hourly rates “on size errors” are detected.
- Control-total check — ensures that no unauthorized changes are made to specified data or data fields and all data have been entered.
- Logic check — ensures that spurious data are rejected, e.g., no negative regular hours.

### N83

Answer 2 (10 points)

a. Purchase orders may vary in format and style. However, all purchase orders should include areas for insertion of the following information, which was not included in the illustration:

- Price
- Purchase order number
- Purchase order execution date
- Authorization signature

b. In the stores department purchase orders serve to

- Verify that the purchase order was executed as authorized.
- Verify that the quantities reported as received in the receiving department are correct.

In the purchasing department purchase orders serve as

- A control copy of outstanding orders until the order is received.
- A control copy that accounts for the numerical sequence of all purchase orders (to detect unauthorized use).

In the receiving department purchase orders serve to

- Authorize acceptance of specified merchandise.
- Establish an independent verification of quantities received (usually by compelling a blind count).

In the accounting department purchase orders serve to

- Verify that the acquisition was authorized.
- Verify the accuracy of the terms of the vendor’s invoice.
- Authorize payment upon proof of delivery.

### M83

Answer 5 (10 points)

- A. Prepare purchase order
- B. To vendor
- C. Prepare receiving report
- D. From purchasing
- E. From receiving
- F. Purchase order no. 5
- G. Receiving report no. 1
- H. Prepare and approve voucher
- I. Unpaid voucher file, filed by due date
- J. Treasurer
- K. Sign checks and cancel voucher package documents
- L. Cancelled voucher package

### N82

Answer 3 (10 points)

The system of internal control should provide for—

- Drivers to count and then sign for all merchandise received.
- Daily verification of each driver’s ending inventory.
- Cash to be deposited daily by each driver.
- Daily return of duplicate deposit slips by each driver.
- Reconciliation of cash deposits with the daily net change in inventory.
- Provision for explanation of overages and shortages.
- A periodic independent surprise check of machines to verify that—
  - a. Machines contain only authorized Trapan-purchased merchandise.
  - b. Machines are mechanically programmed to charge the authorized prices.
  - c. Cash and merchandise in machines equal a predetermined (imprest) total.
- Bonding of employees.
- Alternate driver routes and required vacations.
- Restricting access to the warehouse.
- The warehouseman to count and sign for all items going into or out of the warehouse.
- Maintenance of perpetual inventory records.
- Periodic physical inventory count of merchandise in the warehouse.
- Analytical review of collections.

### N81

Answer 3 (10 points)

a. The adequacy of internal control is questionable whenever quantities are not blocked out on the copy of the purchase order that is sent to the receiving department, because this practice may cause the receiving clerk to bypass the counting and inspection procedures. The receiving clerk may only compare the purchase order and packing slip (or other document accompa-

nying the shipment) and prepare a receiving report based on these documents. As a result of this weakness, incorrect quantities of merchandise or inferior quality merchandise may be received and accepted. However, in the case of Dunbar Manufacturing, Inc., in certain areas there are compensating controls.

*Receipt of sheetmetal.* Although the receiving clerk may only compare quantities on the purchase order and the bill of lading, there is a compensating control over quantities of sheetmetal received. This compensating control is the independent verification of weights received and date of receipt, which are provided in the bill of lading. However, sheetmetal with unacceptable quality specifications may still be received and accepted.

*Receipt of screws.* Since the receiving clerk weighs the screws upon receipt and the weight is converted to units, control over quantities received is adequate. Furthermore, screws of an unacceptable specification may be expected to be detected during the weighing and inspecting process.

*Receipt of camera lenses.* Because there are no controls that compensate for the weakness in checking actual receipt of camera lenses, there is inadequate control over the quantity and quality of lenses received.

b. Inventory may be overstated and the cost of merchandise sold and income may be misstated because additions to inventory may be based on suppliers' invoices, which may include nonusable items or items that were not received. Further, because the company may have erroneously accrued the cost of nonusable items or items not received, accounts payable may be overstated.

**N80**

**Answer 4 (10 points)**

*Weakness*

1. There is no segregation of duties between persons responsible for collecting admission fees and persons responsible for authorizing admission.
2. An independent count of paying patrons is not made.
3. There is no proof of accuracy of amounts collected by the clerks.
4. Cash receipts records are not promptly prepared.
5. Cash receipts are not promptly deposited. Cash should not be left undeposited for a week.
6. There is no proof of accuracy of amounts deposited.
7. There is no record of the internal accountability for cash.

*Recommendation*

1. One clerk (hereafter referred to as the collection clerk) should collect admission fees and issue pre-numbered tickets. The other clerk (hereafter re-

ferred to as the admission clerk) should authorize admission upon receipt of the ticket or proof of membership.

2. The admission clerk should retain a portion of the prenumbered admission ticket (admission ticket stub).
3. Admission ticket stubs should be reconciled with cash collected by the treasurer each day.
4. The cash collections should be recorded by the collection clerk daily on a permanent record that will serve as the first record of accountability.
5. Cash should be deposited at least once each day.
6. Authenticated deposit slips should be compared with daily cash collection records. Discrepancies should be promptly investigated and resolved. In addition, the treasurer should establish policy that includes an analytical review of cash collections.
7. The treasurer should issue a signed receipt for all proceeds received from the collection clerk. These receipts should be maintained and should be periodically checked against cash collection and deposit records.

**M80**

**Answer 5 (10 points)**

a. Weaknesses in the system of internal control are the following:

1. Lack of approval of the foreman's clock card by an appropriate supervisor is an unsound practice. Employees should not be permitted to maintain their own time records and submit them without approval.
2. The computation of regular and overtime hours prepared by payroll clerk no. 2 that is used in the preparation of the payroll register is not compared with the summary of regular and overtime hours prepared by the foreman.
3. Arithmetic computations and rates of pay used in the preparation of the payroll register are not checked by a person who is independent of their preparation and payroll register columns are not verified (readed) by a person other than the preparer of the payroll register.
4. Payroll checks are not reconciled to the payroll register in order to prevent improper disbursements.
5. A signature-stamp machine should not be in the custody of any payroll clerk who has access to unsigned checks.
6. Payroll is not approved by an officer of the company.
7. Since the paymaster should be independent of the payroll process, signed payroll checks should not be distributed by the foreman.
8. Unclaimed payroll checks should be in the custody of an employee who is independent of the payroll process.
9. The comparison of (regular and overtime) hours indicated on payroll check (or attachments) with (regular and overtime) hours indicated on clock

## Auditing

- cards should not be performed by the clerk who is responsible for the original computation of (regular and overtime) hours indicated on clock cards.
10. The comparison of gross and net payroll indicated on payroll check (or attachments) with gross and net payroll indicated in the payroll register should not be performed by the clerk who is responsible for preparing the payroll register.
- b. One should inquire whether:
1. Payroll clerk no. 2 checks clock cards for the foreman's written approval.
  2. Approved overtime is indicated on clock cards.
  3. Employment, wage, and related data in payroll files are periodically crosschecked with personnel files for agreement.
  4. The punching of clock cards is observed by a timekeeper.
  5. Other mitigating internal control measures (for example, bonding, required vacations, and so forth) are in existence.

### D. Other Considerations

**N82**

**Answer 2** (10 points)

- a. The remaining steps are as follows:
4. Define the attributes (characteristics) of interest to be tested (including the criteria for establishing the existence of errors or deviant conditions).
  5. Set the maximum rate of deviations from a prescribed control procedure that would support the planned reliance on the control (tolerable rate).
  6. Select a confidence level (quantify the risk of overreliance).
  7. Estimate the population error rate (deviation rate).
  8. Determine the sample size.
  9. Choose a method for randomly selecting a sample.
  10. Perform the compliance audit procedures.
  11. Perform error analysis (calculate the deviation rate and consider the qualitative aspects of the deviations).
  12. Interpret sample results (calculate a population deviation rate).
  13. Decide on the acceptability of the results of the sample.
- b. Statistical sampling methodology helps the auditor (1) to design an efficient sample, (2) to measure the sufficiency of the evidential matter obtained, and (3) to evaluate the sample results. By using a statistical sampling methodology, the auditor can quantify sampling risk to assist in limiting it to an acceptable level.

## III. Audit Evidence and Procedures

### A. Audit Evidence

**N83**

**Answer 4** (10 points)

Taylor should perform the following additional substantive audit procedures.

- Foot the client-prepared schedule.
- Tie the general ledger accounts payable control account to the client-prepared accounts payable schedule.
- Examine vendors' statements in support of items on the client-prepared schedule.
- Examine other documents (such as approved vouchers) in support of items on the client-prepared schedule.
- Review the general ledger control account for non-cash debits or unusual items, and investigate them.
- Confirm, with positive confirmation requests, account balances from vendors with account balances and vendors with zero account balances.
- Examine unpaid invoices on hand (to ascertain whether any were erroneously omitted from the client-prepared schedule of accounts payable).

- Examine documents in support of invoices paid subsequent to the year end (to ascertain whether the payable was recorded in the appropriate year).
- Inspect receiving reports (to test the accuracy of the year-end cutoff).
- Ascertain whether year-end outstanding checks to vendors were returned with the cutoff bank statement.
- Review correspondence files with respect to disputed items.
- Review open purchase orders for unusual or old items that may have been received but not recorded.
- Examine unmatched receiving reports.
- Make certain that the client representation letter includes the proper assertions concerning accounts payable.
- Investigate and resolve confirmation exceptions and other matters requiring followup.

**N83**

**Answer 5** (10 points)

- a. The auditor's objectives during the examination of noncurrent investment securities are to obtain evidence regarding the



- Existence of the investment securities at the balance sheet date.
- Ownership of the investment securities.
- Cost and carrying value of the investment securities.
- Proper presentation and disclosure of the investment securities in the financial statements.
- Proper recognition of interest income.
- Proper recognition of investment gains and losses.

b. The following audit procedures should be undertaken by Kent in order to fulfill the audit objectives referred to above in response to part a.

- Inspect and count securities in the company's safe and safe deposit box.
- Examine brokers' statements to obtain assurance that all transactions were recorded.
- Examine documents in support of purchases and sales of investment securities.
- Obtain market quotations for all investment securities as of the balance sheet date.
- Inspect minutes of the board of directors meetings.
- Review the audited financial statements of the (25 percent) investee.
- Verify that the equity method of accounting was used for the carrying value of the investment in Commercial Industrial.
- Obtain a client representation letter that confirms the client's representations concerning the noncurrent investment securities.
- Verify the calculation of interest income.
- Review the propriety of the presentation and disclosure of the securities in the financial statements.

**M83**

**Answer 2** (10 points)

Other matters that Alderman's representation letter should specifically confirm include whether or not—

- Management acknowledges responsibility for the fair presentation in the financial statements of financial position, results of operations, and changes in financial position in conformity with generally accepted accounting principles (or other comprehensive basis of accounting).
- All material transactions have been properly reflected in the financial statements.
- There are other material liabilities or gain or loss contingencies that are required to be accrued or disclosed.
- The company has satisfactory title to all owned assets, and whether there are liens or encumbrances on such assets or any pledging of assets.
- There are related party transactions or related amounts receivable or payable that have not been properly disclosed in the financial statements.
- The company has complied with all aspects of contractual agreements that would have a material ef-

fect on the financial statements in the event of noncompliance.

- Events have occurred subsequent to the balance sheet date that would require adjustment to, or disclosure in, the financial statements.
- The accountant has been advised of all actions taken at meetings of stockholders, board of directors, and committees of the board of directors (or other similar bodies) that may affect the financial statements.
- All financial records and data were made available.
- Management is aware of irregularities that could have a material effect on the financial statements or that involve management or employees who have significant roles in the system of internal control.
- Provision, when material, has been made to reduce excess or obsolete inventories to their estimated net realizable value.
- Provision has been made for any material loss to be sustained in the fulfillment of, or from inability to fulfill, any sales commitments.
- Provision has been made for any material loss to be sustained as a result of purchase commitments for inventory quantities in excess of normal requirements or at prices in excess of the prevailing market prices.

**M83**

**Answer 4** (10 points)

Basic audit procedures that should be performed by Kautz in gathering evidence in support of each of the items (a) through (f) are as follows:

Balance per bank (item a)

- Confirm by direct written communication with bank.
- Obtain and inspect a January-1983-cutoff bank statement directly from the bank (examine opening balance).

Deposit in transit (item b)

- Verify that the deposit was listed in the January-1983-cutoff bank statement on a timely basis.
- Trace to the cash receipts journal.
- Inspect the client's copy of the deposit slip for the date of deposit.

Outstanding checks (item c)

- Trace to the cash disbursements journal.
- Examine all supporting documents for those outstanding checks that were not returned with the cutoff bank statement.
- Examine checks accompanying the January-1983-cutoff bank statement and trace all 1982, or prior, checks to the outstanding check list.
- Ascertain why check number 837 is still outstanding, if possible.

NSF check returned (item d)

- Follow up on the ultimate disposition of the NSF check.
- Examine all supporting documents.

Note collected (item e)

- Examine bank credit memo.

Balance per books (item f)

- Foot this total and compare this balance with the general ledger balance.

**N82**

**Answer 4** (10 points)

a. The procedures that Andrews should employ in examining the loans are as follows:

- Obtain an understanding of the business purpose of the loans made by the president.
- Confirm the loans, including terms, by direct communication.
- Recompute (or verify) interest expense and interest payable.
- Recompute the long-term and short-term portions of the debt.
- Review minutes of meetings of the board of directors for proper authorization.
- Verify payments made during the year and transactions after the year end.
- Read (notes to) the financial statements and the loan agreements, and evaluate the adequacy of disclosure and compliance with restrictions.
- Obtain a management representation letter.

b. Broadwall's financial statements should disclose the following information concerning the loans from its president:

- The nature of the related-party relationship
- The dollar amounts of the loans
- Amounts due the president and, if not otherwise apparent, the terms and manner of settlement

**M82**

**Answer 2** (10 points)

In order to determine whether lapping exists, Stanley would test the aging of accounts receivable and then—

- Mail positive accounts receivable confirmation requests directly to all customers with old balances.
- Investigate all exceptions noted on confirmations.
- Obtain authenticated deposit slips directly from the bank.
- Compare individual customers' names, dates, and amounts shown on the customers' remittance advices with the names, dates, and amounts recorded in the cash receipts journal, individual customer ledger accounts, and deposit slips (if practicable).

- Verify the propriety of noncash credits to accounts receivable (for example, sales discounts, sales returns, bad debt write-offs).
- Perform a surprise inspection of deposits.
- Foot the cash receipts journal, the customers' ledger accounts, and the accounts receivable control account.
- Reconcile the total of the individual customers' accounts with the accounts receivable control account.
- Compare information in copies of monthly customers' statements with information in customers' ledger accounts.

**N81**

**Answer 2** (10 points)

a. The types of information, aside from premium information, that would ordinarily be included in an insurance schedule are as follows:

- Name of insurance companies
- Insurance policy numbers
- Type of insurance coverage
- Amount of coverage
- Time periods that are covered
- Coinsurance percentages
- Unusual riders or specified obligations

b. The basic audit procedures that Robbins should perform in examining the client-prepared insurance schedule are as follows:

- Analytically review insurance.
- Ascertain whether all major assets and all major risks are covered by insurance.
- Compare current values of assets with insured values.
- Confirm that insurance is in force.
- Vouch information on the insurance schedule to insurance policies.
- Vouch amount of premiums to client records.
- Foot appropriate columns in the insurance schedule.
- Reconcile prepaid insurance and insurance expense per insurance schedule to the balances in the client's general ledger account.
- Ascertain whether management periodically reviews the insurance coverage.

**M81**

**Answer 5** (10 points)

The tests, including analytical review procedures, that Decker should apply are as follows:

- Trace entries to perpetual inventory records from receiving reports and shipping reports.
- Trace entries from perpetual inventory records to receiving reports and shipping reports.
- Compare records of monthly physical counts with perpetual inventory records.

- Ascertain whether perpetual inventory records have been adjusted based upon physical counts.
- Test arithmetic accuracy of perpetual inventory records.
- Reconcile beginning inventory quantities with ending inventory quantities.
- Ascertain the consistency of the methods of determining cost and market value.
- Compare unit costs on inventory listings with paid vouchers (purchase orders and vendor's invoices).
- Compare financial information with information for comparable prior periods (for example, inventory turnover, gross profit percentage, dollar and unit sales, and so forth).
- Compare financial information with anticipated results (based upon budgets, forecasts, trends analysis, long-term agreements, commitments, and so forth).
- Study the relationships of elements of financial information that would be expected to conform to a predictable pattern based upon the entity's experience (for example, perform a comparison of statistical data from sales departments with accounting records or relationships between changes in sales and changes in accounts receivable balances).
- Compare the financial information with similar information regarding the industry in which the entity operates (for example, government publications, trade association data, and so forth).
- Study relationships of the financial information with relevant nonfinancial information (for example, relate insurance coverage to inventory amounts, compare inventory quantities with storage capacity of storage facilities, and so forth).
- Apply other appropriate audit procedures which may be deemed necessary in the circumstances.

**M80**

**Answer 4** (10 points)

a. Substantive tests are procedures designed to test for dollar errors that directly affect the fair presentation of financial statement balances. A basic premise underlying the application of analytical review procedures is that data relationships may reasonably be expected by the auditor to exist and continue in the absence of known conditions to the contrary. Since the presence of those relationships provides the auditor with evidential matter required by the third standard of fieldwork, analytical review procedures that test for the presence of such relationships are considered substantive tests.

b. In the initial planning stages, analytical review procedures may be used to assist in determining the nature, extent, and timing of other auditing procedures by identifying, among other things, significant matters that require consideration during the examination.

c. The analytical review procedures that one would expect a CPA to utilize during an examination in ac-

cordance with generally accepted auditing standards include the following:

- Comparison of the financial information with information for comparable prior period(s).
- Comparison of the financial information with anticipated results (for example, budgets and forecasts).
- Study of the relationships of elements of financial information that would be expected to conform to a predictable pattern based on the entity's experience.
- Comparison of the financial information with similar information regarding the industry in which the entity operates.
- Study of relationships of the financial information with relevant nonfinancial information.

**B. Specific Audit Objectives and Procedures**

**N84**

**Answer 2** (10 points)

Substantive audit procedures that Pierce should use in examining Mayfair's mobile construction equipment and related depreciation would include the following:

- Determine that the equipment account is properly footed.
- Determine that the subsidiary accounts agree with controlling accounts.
- Obtain, or prepare, an analysis of changes in the account during the year.
- Determine that beginning-of-year balances agree with the prior year's ending balances.
- Inspect documents in support of additions during the year.
- Inspect documents in support of retirements during the year.
- Analyze repairs and maintenance for possible reclassifications.
- Determine the propriety of accounting for equipment not in current use.
- Test the accuracy of equipment and accounting records by —
  - Selecting items from the accounting records and verifying their physical existence.
  - Selecting items of equipment and locating them in the accounting records.
- Evaluate the reasonableness of estimated lives and methods of depreciation used.
- Test the calculation of depreciation expense and accumulated depreciation balance.
- Perform analytical review procedures such as comparing depreciation expense to balance sheet accounts for proper relationship and comparing the current year's depreciation expense with prior year's depreciation expense.

## Auditing

- Evaluate the financial statement presentation and disclosures for conformity with generally accepted accounting principles.
- Review insurance coverage.

### M84

#### Answer 5 (10 points)

To substantiate the validity of gross apartment rents, Finney would —

- Physically examine the rental property or review architectural blueprints to ascertain the total number of rental units.
- Compare the total number of validated rental units with the total number of rent charges on the schedule of gross apartment rents (Schedule A).
- For occupied units, vouch the individual apartment rental charges per lease agreements to the individual rental charges on Schedule A.
- For unoccupied (vacant) units, ascertain the reasonableness of the scheduled rent (by reference to the last rent paid, by reference to comparable rental charges for similar units, etc.).
- Foot the gross apartment rent schedule (Schedule A) and compare the total with the figure indicated on the rent reconciliation.

To substantiate the validity of the vacancies, Finney would —

- Physically examine the apartments that were vacant during the month.
- Compare the rental charge (validated in the gross apartment rents procedures above) for each vacant apartment with the schedule of vacancies (Schedule B).
- Foot the schedule of vacancies (Schedule B) and compare the total with the total indicated on the rent reconciliation.

To substantiate the validity of unpaid January rents, Finney would —

- Trace unpaid rents from individual tenant apartment ledger cards to Schedule C.
- Foot the unpaid rents schedule (Schedule C) and compare the total with the amount shown on the rent reconciliation.
- Examine the collection file for evidence of collection attempts.
- Request written confirmations from tenants with accounts in January arrears.

To substantiate the validity of the prepaid rent collected, Finney would —

- Trace the receipt to the individual tenant apartment ledger card.

- Compare the amount collected with the lease terms.

To substantiate the validity of the cash collected, Finney would —

- Foot the client-prepared rent reconciliation.
- Reconcile the cash receipts per the rent reconciliation with the books and records.
- Confirm and reconcile the special bank account balance.

### M82

#### Answer 4 (10 points)

a. The following information is missing:

- The date of purchase of S security
- The date of purchase and sale of R security
- Data concerning the accrual and/or receipt of interest due on R to date of sale
- Data concerning the accrual and/or payment of interest due on S to the date of purchase
- Justification for accrual of dividends
- Accounting treatment of bond discount
- Data concerning the December 31, 1980, revenue accruals
- Data required to evaluate the classification of securities

b. The following procedures were not noted as having been performed:

- The securities were not physically inspected or confirmed.
- The broker's advice (or other independent corroborating evidence) verifying the sale of R was not examined.
- Dividend rates were not verified by reference to public records (Standard & Poor's) of dividend declarations.
- The stated interest rates, maturity dates, and market values were not verified.
- Computations of year-end accruals were not made.
- Not all amounts (for example, loss on sale of R) were traced to the general ledger.

### N80

#### Answer 5 (10 points)

a. In order to verify the information in the input form James should—

- Compare name, social security number, and withholding data on the input form with W-4 forms.
- Compare names with employment authorizations.
- Compare pay rates with wage authorizations and union contracts.
- Compare number of hours worked (regular and overtime) with approved time sheets or other sup-

portive records; recompute regular and overtime hours.

- Inspect employee authorization forms for “special deductions.”

b. James should perform the following procedures in the examination of the November 23, 1979, payroll register:

- Compare information on the input form with information in the payroll register and information on issued payroll checks (for example, spelling of names, correctness of social security numbers, hours, rates, and deductions).
- Test payroll deductions by using withholding tax tables to recompute social security and withholding taxes.
- Manually compute gross and net pays and compare with computer printed figures.
- Compare payroll summary totals with other pay periods; investigate any unusual variations among periods.
- Check footings and crossfootings in the payroll register.
- Perform other related basic auditing procedures that may be deemed necessary in accordance with the circumstances.

### C. Other Specific Topics

**M81**

**Answer 2** (10 points)

a. A subsequent event is an event or transaction that occurs subsequent to the balance sheet date but prior to the issuance of the financial statements and auditor’s report that has a material effect on the financial statements and therefore requires adjustment or disclosure in the financial statements.

b. The occurrence of subsequent events that provide additional evidence regarding conditions that existed at the date of the balance sheet and affect the estimates inherent in the process of preparing financial statements necessitate financial statement adjustment. Those events that provide evidence regarding conditions that did not exist at the date of the balance sheet being reported on but arose subsequent to that date ordinarily would not result in adjustment of the financial statements.

Some of these latter events, however, may be such that disclosure of them is required to keep the financial statements from being misleading. Occasionally such an event may be so significant that disclosure can best be made by supplementing the historical financial state-

ments with pro forma financial data giving effect to the event as if it had occurred on the balance sheet date.

c. The specific procedures that should be performed in order to ascertain the occurrence of subsequent events are these:

- Read the latest available interim financial statements, compare them with the financial statements being reported upon, and make any other comparisons considered appropriate in the circumstances. Inquire of officers and other executives having responsibility for financial and accounting matters whether the interim statements have been prepared on the same basis as that used for the statements under examination.
- Inquire of and discuss with officers and other executives having responsibility for financial and accounting matters (limited, where appropriate, to major locations) regarding:
  - a. Whether any substantial contingent liabilities or commitments existed at the date of the balance sheet being reported on or at the date of inquiry.
  - b. Whether there was any significant change in the capital stock, long-term debt, or working capital to the date of inquiry.
  - c. The current status of items in the financial statements being reported on that were accounted for on the basis of tentative, preliminary, or inconclusive data.
  - d. Whether any unusual adjustments have been made during the period from the balance sheet date to the date of inquiry.

- Read the available minutes of meetings of stockholders, directors, and appropriate committees; inquire about matters dealt with at meetings for which minutes are not available.
- Obtain from the client’s legal counsel a description and evaluation of any litigation, impending litigation, claims, and contingent liabilities (of which counsel has knowledge) that existed at the date of the balance sheet being reported on, together with a description and evaluation of any additional matters of such nature that have come to counsel’s attention up to the date the information is furnished.
- Obtain a letter of representations, dated as of the date of the auditor’s report, from appropriate officials (generally the chief executive officer and chief financial officer) regarding whether any events occurred subsequent to the date of the financial statements being reported on by the independent auditor that, in the officer’s opinion, would require adjustment or disclosure in these statements.
- Make such additional inquiries or perform such procedures as considered necessary and appropriate to dispose of questions that arise in carrying out the foregoing procedures, inquiries, and discussions.

**M80**

**Answer 3** (10 points)

a. Based upon the information given, the computer may be used by Hastings to do the following:

- Test extensions and footings of computerized sales records that serve as a basis for the preparation of the invoices and sales journal.
- Verify the mathematical accuracy of postings from the sales journal to appropriate ledger accounts.
- Determine that all sales invoices and other related documents have been accounted for (for example, by accounting for the integrity of the numerical sequence).
- Select sales transactions for review (based upon predetermined criteria) through a review of the sales journal or the accounts receivable subsidiary ledger.
- Print a workpaper that lists each item selected, with relevant data inserted in applicable columns.
- Select all debits posted to the sales account and all postings to the sales account from a source other than the sales journal.
- Analytically review recorded sales by use of predetermined criteria (percentage relationships, gross margin, trends, and so forth, on a periodic or annual basis).
- Compare duplicate data maintained in separate files for correctness. For example, the computer may be used to compare the client's records of quantities sold with the client's records of quantities shipped.
- Examine records for quality (completeness, consistency, and so forth). [The quality of visible rec-

ords is readily apparent to the auditor. Sloppy recordkeeping, lack of completeness, and so on, are observed by the auditor in the normal course of the audit. If machine-readable records are evaluated manually, a complete printout is needed to examine their quality. Hastings may choose to use the computer to examine these records for quality.]

b. In addition to the procedures outlined above, Hastings should do the following:

- Trace postings from the sales journal to invoice copies.
- Trace data from sales invoices to the sales journal.
- Compare dates of recorded sales transactions with dates on shipping records.
- Determine that all shipping documents have been accounted for (for example, by accounting for the integrity of the numerical sequence).
- Examine documents for appropriate approval (for example, grant of credit, shipment of goods, and determination of price and billing).
- Determine the extent and nature of business transacted with major customers (for indications of previously undisclosed relationships—related parties—and for determination of applicability of disclosure requirements required by generally accepted accounting principles).
- Verify the sales cutoff at the beginning and end of the period to determine whether the recorded sales represent revenues of the period.
- Test pricing by comparing invoices to daily price list.

#### IV. Reporting

##### A. Reporting Standards and Types of Reports

**N84**

**Answer 5** (10 points)

To the Board of Directors of Devon Incorporated:

We have examined the balance sheet of Devon Incorporated as of December 31, 1983, and the related statements of income, retained earnings, and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. The financial statements of Devon Incorporated for the year ended December 31, 1982, were examined by other auditors whose report dated March 31, 1983, expressed an unqualified opinion on those statements.

During the year, Devon changed its method of valuing inventory from the first-in, first-out method to the last-in, first-out method. This change was made because management believes LIFO more clearly reflects net income by providing a closer matching of current costs and current revenues. The change had the effect of reducing inventory at December 31, 1983, by \$65,000, and net income and earnings per share by \$38,000 and \$.38, respectively, for the year then ended. The effect of the change on prior years was immaterial; accordingly, there was no cumulative effect of the change.

The company has excluded from property and debt in the accompanying balance sheet certain lease obligations, which, in our opinion, should be capitalized in order to conform with generally accepted accounting principles. If these lease obligations were capitalized, assets would be increased by \$312,000 and liabilities by \$387,000, and retained earnings would be decreased by \$75,000 as of December 31, 1983; net income and earn-

Unofficial Answers

ings per share would be decreased by \$75,000 and \$.75, respectively, for the year then ended.

In our opinion, except for the effects of not capitalizing lease obligations, and except for not disclosing the change in inventory methods as discussed in the preceding paragraphs, the financial statements referred to above present fairly the financial position of Devon Incorporated as of December 31, 1983, and the results of its operations and the changes in its financial position for the year then ended, in conformity with generally accepted accounting principles, applied on a basis consistent with that of the preceding year, except for the change, with which we concur, in the method of valuing inventory as disclosed in the second preceding paragraph.

Smith, CPA

February 29, 1984

**M84**

**Answer 2** (10 points)

Board of Directors  
XYZ Company, Inc.

We have examined the financial statements of XYZ Company, Inc., for the year ended June 30, 1983, and have issued our report thereon dated August 15, 1983. Our examination was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In the course of our examination, we examined the provision for federal and state income taxes for the year ended June 30, 1983, and the related accruals and deferred income taxes included in XYZ Company's financial statements referred to in the preceding paragraph. We also reviewed the federal and state income tax returns filed by XYZ Company that are subject to examination by the respective taxing authorities.

In our opinion, XYZ Company has made adequate provision for all federal and state income taxes and has properly reflected the related accruals and deferred income taxes applicable to fiscal 1983 and prior fiscal years that could be reasonably estimated at the time of our examination of the financial statements of XYZ Company, Inc., for the year ended June 30, 1983.

August 15, 1983

Young and Young  
Certified Public Accountants

**N83**

**Answer 3** (10 points)

To the shareholders and board of directors, Fairfax Corporation:

We have examined the balance sheet of Fairfax Corporation as of December 31, 1982, and the related statements of income, retained earnings, and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. The financial statements of Fairfax Corporation for the year ended December 31, 1981, were examined by other independent auditors, whose reports dated March 1, 1982, on those statements expressed an unqualified opinion on the balance sheet of December 31, 1981, and a qualified opinion with respect to the statements of income, retained earnings, and changes in financial position for the year then ended due to an inability to determine the effects on these 1981 financial statements of such adjustments, if any, as might have been determined to be necessary had the January 1, 1981, physical inventory been observed.

In our opinion, the 1982 financial statements referred to above present fairly the financial position of Fairfax Corporation as of December 31, 1982, and the results of its operations and the changes in its financial position for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Ross, Sandler & Co.

March 17, 1983

**M83**

**Answer 3** (10 points)

Deficiencies in the auditor's report, as drafted by the audit assistant, may be categorized as follows:

- The scope paragraph did not specifically identify the financial statements that were examined or the period of time they covered. Further, the scope paragraph did not specifically state that the examination included tests of accounting records, and it did not refer the reader to the second middle paragraph.
- The second middle paragraph, which should have been explanatory, improperly disclaimed an opinion on the financial statements taken as a whole.
- The opinion paragraph did not express an opinion on the results of operations and changes in financial position for the period, and the period covered by these financial statements was not identified. Further, it did not state that the balance sheet was presented fairly in conformity with generally accepted accounting principles, and it did not refer to the consistent application of generally accepted accounting principles.

If the intent was to express a qualified opinion, the reason for the qualification should have been referred to in both the scope and opinion paragraphs and the wording in the opinion paragraph should

## Auditing

have indicated that the qualification pertained to the possible effects on the financial statements and not the scope limitation itself. Further, the "subject to" phrase should not have been used.

- The report should have been addressed to the Board of Directors; Stockholders; or Corporation.
- The date of the report should have been as of the last date of the fieldwork.

### N82

#### Answer 5 (10 points)

To: The Board of Directors of Tillis Ltd.

We have reviewed the accompanying balance sheet of Tillis Ltd. as of December 31, 1981, and the related statements of income, retained earnings, and changes in financial position for the year then ended, in accordance with standards established by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of the management of Tillis Ltd.

A review consists principally of inquiries of company personnel and analytical procedures applied to financial data. It is substantially less in scope than an examination in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the accompanying 1981 financial statements in order for them to be in conformity with generally accepted accounting principles.

The financial statements for the year ended December 31, 1980, were examined by us, and we expressed an unqualified opinion on them in our report dated February 27, 1981, but we have not performed any auditing procedures since that date.

Novak & Co.

March 3, 1982

### M82

#### Answer 5 (10 points)

a. The assistant's report contained the following assertions that were incorrect or that should have been deleted:

- The report was addressed to Ajax but should have been addressed to Uclean.
- It indicated that an examination (of cash in banks and accounts receivable) was performed in accordance with generally accepted auditing standards.
- It indicated that tests of the accounting records and other auditing procedures were performed as considered necessary in the circumstances.

- The report contained the phrase, "in our opinion."
- It stated that cash in banks and accounts receivable were fairly presented in conformity with generally accepted accounting principles.
- It stated that cash in banks and accounts receivable were presented on a basis consistent with that of the preceding year.
- It recommended the acquisition of Ajax Corporation.

b. The assistant's report should contain the following:

- Disclaimer of opinion
- Indication that distribution of the report was to be restricted to named parties involved
- Enumeration of the procedures that were performed
- A statement of the findings
- Indication that the agreed-upon procedures were not sufficient to constitute an examination in accordance with generally accepted auditing standards
- Statement that the report applies only to the items specified
- Statement that the report does not extend to the financial statements of the company taken as a whole
- The date of the report

### N81

#### Answer 5 (10 points)

a. A separate (middle) paragraph should set forth reasons for the expression of an adverse opinion and the principal effects of the subject matter of the adverse opinion. The separate paragraph should state the following, providing dollar amounts where practicable:

- The company carries its building accounts at appraisal values and provides for depreciation on the basis of such values.
- Buildings, accumulated depreciation, and equity (attributed to appraisals) are overstated.
- Net income is understated.
- Depreciation expense is overstated.

b. The opinion paragraph should contain a reference to the separate paragraph and state that the financial statements do not present fairly the financial position, results of operations, and changes in financial position. No reference to consistency should be made in the opinion paragraph. It should be worded as follows:

In our opinion, because of the effects of the matters discussed in the preceding paragraph, the financial statements referred to above do not present fairly, in conformity with generally accepted accounting principles, the financial position of Sturdy Corporation as of December 31, 1980, or the results of its operations and changes in its financial position for the year then ended.



**M81**

**Answer 3 (10 points)**

Deficiencies in the staff accountant's tentative report include the following:

1. The report should be addressed to the company whose financial statements are being examined or to its board of directors or stockholders. The report should not generally be addressed to the audit committee.
2. The report should state that an examination was performed in accordance with generally accepted auditing standards, which includes tests of the accounting records as well as other auditing procedures.
3. When the principal auditor decides to make reference to the examination of the other auditor, the report should indicate clearly, in both the scope and opinion paragraphs, the division of responsibility regarding the portions of the financial statements examined by each. This was not done.
4. When the principal auditor decides to make reference to the examination of the other auditor, the report should disclose the magnitude of the portion of the financial statements examined by the other auditor. This was not done.
5. Reference to and identification of a specialist in the auditor's report should only occur when the auditor decides to modify the opinion as a result of the report or finding of the specialist and the auditor believes such reference will facilitate an understanding of the reason for the modification. This report should not have referred to the work of Dr. Irwin Same.
6. Although the scope paragraph referred to an examination of the financial statements for the years ended December 31, 1980, and 1979, an opinion was expressed only on the 1980 financial statements.
7. The statement of changes in financial position was not identified in the opinion paragraph, and the "consolidated" entity was not indicated.
8. When there are material uncertainties the outcome of which is not susceptible to reasonable estimation, the auditor should consider whether or not to express an unqualified opinion. In this case, it appears that the auditor's opinion should have been qualified due to the uncertainties described. A "subject to" and not an "except for" opinion would have been appropriate.
9. When there is a change in accounting principle, the opinion paragraph should be modified regarding consistency, indicating the nature of the change. Furthermore, in order to be more informative, the auditor should explicitly indicate concurrence with the change in accounting principle, unless an exception is expressly stated. Furthermore, the consistency phrase used was the phrase recommended when reporting on a single year and not the phrase recommended when reporting on comparative financial statements.

10. Generally, the date of completion of the fieldwork should be used as the date of the auditor's report. Dual dating may be used when a subsequent event disclosed in the financial statements occurs after completion of fieldwork but before issuance of the report. Since the auditor's report is dated March 1, 1981, the dual dating as of January 8, 1981, is inappropriate.

**N80**

**Answer 2 (10 points)**

*Addressee:*

We have examined the statement of assets, liabilities, and capital (income tax (cash) basis) of Bale & Booster, a partnership, as of December 31, 1979, and the related statement of revenue and expenses (income tax (cash) basis) and the statement of changes in partners' capital accounts (income tax (cash) basis) for the year then ended. Our examination was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

As described in note X, the partnership's policy is to prepare its financial statements on the accounting basis used for income tax purposes; consequently, certain revenue and related assets are recognized when received rather than when earned, and certain expenses are recognized when paid rather than when the obligation is incurred. Accordingly, the accompanying financial statements are not intended to present financial position and results of operations in conformity with generally accepted accounting principles.

In addition, the company is involved in continuing litigation relating to patent infringement. The amount of damages, if any, resulting from this litigation cannot be determined at this time.

In our opinion, the financial statements referred to above present fairly the assets, liabilities, and capital of the Bale & Booster partnership as of December 31, 1979, and its revenue and expenses and changes in its partners' capital accounts for the year then ended, on the income tax (cash) basis of accounting as described in note X, which basis has been applied in a manner consistent with that of the preceding year.

*Date*

*Firm Name*

**N80**

**Answer 3 (10 points)**

- a. Knowledge of the entity's business helps the auditor in—
  - Identifying areas that may need special consideration.
  - Assessing conditions under which accounting data are produced, processed, reviewed, and accumulated within the organization.

## *Auditing*

- Evaluating the reasonableness of estimates, such as valuation of inventories, depreciation, allowances for doubtful accounts, and percentage of completion of long-term contracts.
  - Evaluating the reasonableness of management representations.
  - Making judgments about the appropriateness of the accounting principles applied and the adequacy of disclosures.
  - Perceiving conflicts of interest and planning internal control evaluations.
- b. When the auditor states that the financial statements are presented “fairly . . . in conformity with generally accepted accounting principles applied on a consistent basis,” the public is assured that in the auditor’s judgment—
- The accounting principles selected and applied have general acceptance.
  - The accounting principles are appropriate in the circumstances.
  - The financial statements, including the related notes, are informative of matters that may affect their use, understanding, and interpretation.
  - The information presented in the financial statements is classified and summarized in a reasonable manner (neither too detailed nor too condensed).
  - The financial statements reflect the underlying events and transactions within a range of acceptable limits.
  - The comparability of financial statements between periods has not been materially affected by changes in accounting principles.

## SUGGESTED REFERENCES

- AICPA, *The Auditor's Study and Evaluation of Internal Control in EDP Systems* (AICPA, 1977).
- AICPA, *Codification of Statements on Auditing Standards nos. 1 to 47* (Commerce Clearing House, 1984).
- AICPA, *Internal Control: Elements of a Coordinated System and Its Importance to Management and the Independent Public Accountant* (AICPA, 1949).
- AICPA, *Professional Standards, Auditing, Management Advisory Services, Tax Practice, Accounting and Review Services*, vol. 1 (Commerce Clearing House).
- AICPA, *Professional Standards, Ethics, Bylaws, Quality Control*, vol. 2 (Commerce Clearing House).
- Arens and Loebbecke, *Auditing: An Integrated Approach*, 2d ed. (Prentice-Hall, 1980).
- Burton, Palmer, Kay, *Handbook of Accounting and Auditing* (Warren, Gorham & Lamont 1981).
- Cook and Winkle, *Auditing*, 3d ed. (Houghton Mifflin, 1984).
- Davis, Adams, Schaller, *Auditing and EDP*, 2d ed. (AICPA, 1983).
- Defliese, Jaenicke, Sullivan, and Gnospelius, *Montgomery's Auditing*, 10th ed. (Wiley, 1984).
- Kell and Ziegler, *Modern Auditing*, 2d ed. (Warren, Gorham, and Lamont, 1983).
- Meigs, Whittington and Meigs, *Principles of Auditing*, 7th ed. (McGraw-Hill, 1982).
- Ricchiute, *Auditing: Concepts and Standards* (South-Western, 1982).
- Stettler, *Auditing Principles*, 5th ed. (Prentice-Hall, 1982).
- Taylor and Glezen, *Auditing: Integrated Concepts and Procedures*, 3d ed. (Wiley, 1985).
- Weber, *EDP Auditing: Conceptual Foundations and Practice* (McGraw-Hill, 1982).



## **APPENDIX**

### **Content Specification Outline**

#### **Background Information**

The Board of Examiners of the American Institute of Certified Public Accountants believes that content specification outlines will help assure the continuing validity and reliability of the Uniform CPA Examination. The development of the current content specification outlines was accomplished over several years. The Board of Examiners first requested subcommittees of the Board of Examiners (Accounting Practice, Accounting Theory, Auditing, and Business Law) to draft content specification outlines for their respective sections.

The content specification outlines were drafted by each subcommittee with the assistance of the AICPA Examinations Division staff. The chairman of the Board of Examiners then appointed an AICPA task force to coordinate the outlines and to recommend how the content specifications should be exposed to the profession. The task force recommended that the Board of Examiners approve the content specification outlines for exposure to the profession through an AICPA exposure draft for public comment.

On March 10, 1980, the exposure draft — *Proposed Content Specification Outlines for the Uniform Certified Public Accountant Examination* — was issued. The exposure draft was sent to

- *Members of AICPA Council.*
- *State Boards of Accountancy.*
- *Representatives of the National Association of State Boards of Accountancy (NASBA).*
- *AICPA Education Executive Committee.*
- *American Accounting Association — Committee on Professional Examinations.*
- *Persons who requested copies.*

The board considered written comments received from the public, oral comments delivered at Board of Examiners' open meetings, and information submitted by NASBA, which gathered data through various state boards sponsoring special seminar sessions to review the *Proposed Content Specification Outlines for The Uniform Certified Public Accountant Examination*. Based on this input, the board made certain modifications to the exposure draft. The content specification outlines were approved by the Board of Examiners on August 31, 1981.

#### **Meaning and Use of Content Specification Outlines**

The content specification outlines are divided into three levels — areas, groups, and topics — with the following outline notations:

- Areas by Roman numerals (I. Area).
- Groups by capital letters (A. Group).
- Topics by Arabic numbers (1. Topic).

The content specification outlines list the areas, groups, and topics to be tested, and also indicate the approximate percentage of the total test score devoted to each area. Some of the uses of the outlines will be to

- Assure consistent subject matter coverage from one examination to the next.
- Assist candidates in preparing for the examination by indicating subjects which may be covered by the examination.
- Provide guidance to those who are responsible for preparing the examination in order to assure a balanced examination.
- Alert accounting educators as to the subject matter considered necessary to prepare for the examination.

## *Auditing*

The relative weight given to each area is indicated by its approximate percentage allocation. The examination will sample from the groups and topics listed within each area in order to meet the approximate percentage allocation. Generally, the group title should be sufficient to indicate the subject matter to be covered. However, in certain instances, topics have been explicitly listed in order to clarify or limit the subject matter covered within a group.

No weight allocations are given for groups or topics. For example, if there are several groups within an area or several topics within a group, no inference should be drawn about the relative importance or weight to be given to these groups or topics on an examination.

The content specification outlines are considered to be complete as to the subjects to be tested on an examination, including recent professional developments as they affect these subjects. Candidates should answer examination questions, developed from these outlines, in terms of the most recent developments, pronouncements, and standards in the accounting profession. When new subject matter is identified, the outlines will be amended to include it and this will be communicated to the profession.

### **Auditing Section**

The Auditing section tests the candidates' knowledge of generally accepted auditing standards and auditing procedures. The scope of the Auditing section includes professional responsibilities, internal control, audit evidence and procedures, and reporting.

In preparing for this section, candidates should study publications such as

- AICPA Code of Professional Ethics.
- Statements on Auditing Standards.
- Statements on Standards for Accounting and Review Services.
- Statements on Quality Control Standards.
- Statements on Management Advisory Services.
- Statements on Responsibilities in Tax Practice.
- AICPA Audit Guides.
- Auditing textbooks.
- Leading accounting journals.

### **Auditing — Content Specification Outline**

#### **I. Professional Responsibilities (15%).**

##### **A. General Standards and Rules of Conduct**

1. Proficiency
2. Independence
3. Due Care
4. Rules of Conduct

##### **B. Control of the Audit**

1. Planning and Supervision
2. Quality Control

##### **C. Other Responsibilities**

1. Detection of Errors or Irregularities
2. Illegal Acts by Clients
3. Responsibilities in Management Advisory Services
4. Responsibilities in Tax Practice
5. Continuing Professional Education and Familiarity with Topics of Current Concern to the Profession

**II. Internal Control (30%).**

**A. Definitions and Basic Concepts**

1. Purpose of Auditor's Study and Evaluation
2. Definitions and Basic Concepts

**B. Study and Evaluation of the System**

1. Review of the System
2. Tests of Compliance
3. Evaluation of Weaknesses

**C. Cycles**

1. Sales, Receivables, and Cash Receipts
2. Purchases, Payables, and Cash Disbursements
3. Inventories and Production
4. Personnel and Payroll
5. Property, Plant, and Equipment

**D. Other Considerations**

1. Required Communication of Material Weaknesses
2. Reports on Internal Control
3. Sampling
4. Effects of EDP
5. Flowcharting
6. Effects of an Internal Audit Function

**III. Audit Evidence and Procedures (30%).**

**A. Audit Evidence**

1. Nature, Competence, and Sufficiency of Evidential Matter
2. Analytical Review Procedures
3. Evidential Matter for Receivables and Inventory
4. Evidential Matter for Long-Term Investments
5. Client Representations
6. Using the Work of a Specialist
7. Inquiry of a Client's Lawyer
8. Related Party Transactions

**B. Specific Audit Objectives and Procedures**

1. Tests of Details of Transactions and Balances
2. Documentation

**C. Other Specific Topics**

1. Use of the Computer in Performing the Audit
2. Use of Statistical Sampling in Performing the Audit
3. Subsequent Events
4. Operational Auditing

IV. Reporting (25%).

A. Reporting Standards and Types of Reports

1. Scope of Examination
2. Generally Accepted Accounting Principles
3. Consistency
4. Disclosure
5. Reporting Responsibilities
6. Unqualified
7. Qualified
8. Adverse
9. Comparative
10. Disclaimer
11. Compilation and Review
12. Review of Interim Financial Information
13. Special Reports
14. Negative Assurance

B. Other Reporting Considerations

1. Subsequent Discovery of Facts Existing at the Date of the Auditor's Report
2. Dating of the Auditor's Report
3. Part of Examination Made by Other Independent Auditors
4. Letters for Underwriters
5. Filing Under Federal Securities Statutes
6. Segment Information
7. Other Information in Documents Containing Audited Financial Statements
8. Supplementary Information Required by the FASB
9. Information Accompanying the Basic Financial Statements



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