

Testbank

to accompany

Auditing: a practical approach 3e

by

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WILEY

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Chapter 1: Introduction and overview of audit and assurance

True/False

1. The nature of audit procedures refers to the reliance on evidence provided by the client and its management.

- *a. True
- b. False

Correct answer: a

Learning Objective 1.2 ~ Discriminate between different types of assurance services

2. A compliance audit involves gathering evidence to ascertain whether the person or entity under review has followed the rules, policies, procedures, laws and regulations with which they must conform.

- *a. True
- b. False

Correct answer: a

Learning Objective 1.2 ~ Discriminate between different types of assurance services

3. An operational audit is an example of a compliance audit.

- a. True
- *b. False

Correct answer: b

Learning Objective 1.2 ~ Discriminate between different types of assurance services

4. The most common types of assurance engagements are financial report audits, confirmation audits, performance audits, comprehensive audits and assurance on corporate social responsibility (CSR) disclosures.

- a. True
- *b. False

Correct answer: b

Learning Objective 1.2 ~ Discriminate between different types of assurance services

5. An assurance engagement is performed by an auditor or consultant to enhance the reliability of the subject matter.

- *a. True
- b. False

Correct answer: a

Learning Objective 1.2 ~ Discriminate between different types of assurance services

6. An audit of a financial report by the contracted auditors will give absolute assurance that the financial reports give a true and fair view of the financial performance of the entity.

- a. True
- *b. False

Correct answer: b

Learning Objective 1.3 ~ Discriminate between different levels of assurance

7. An audit engagement is performed by an Auditor to provide a reasonable assurance that the financial report gives a true and fair view of the business activities for the period.

- *a. True
- b. False

Correct answer: a

Learning Objective 1.3 ~ Discriminate between different levels of assurance

8. A no assurance engagement is of little use as no assurance is given to the client.

- a. True
- *b. False

Correct answer: b

Learning Objective 1.3 ~ Discriminate between different levels of assurance

9. An auditor can provide a reasonable level of assurance on information other than historical financial information.

- *a. True
- b. False

Correct answer: a

Learning Objective 1.3 ~ Discriminate between different levels of assurance

10. A negative expression of opinion is only given when there is a disagreement with management and the auditor.

- a. True
- *b. False

Correct answer: b

Learning Objective 1.3 ~ Discriminate between different levels of assurance

11. A reasonable level of assurance is the highest level of assurance that an auditor can provide.

- *a. True
- b. False

Correct answer: a

Learning Objective 1.3 ~ Discriminate between different levels of assurance

12. All modified audit reports are qualified audit opinions.

- a. True
- *b. False

Correct answer: b

Learning Objective 1.4 ~ Categorise different audit opinions

13. It is the auditor's responsibility to prepare the financial statements.

- a. True
- *b. False

Correct answer: b

Learning Objective 1.5 ~ Discriminate between the different role of the preparer and the auditor, and discuss the different firms that provide assurance services

14. Insurance hypothesis is a means whereby the investor can guarantee the success of their investment.

- a. True
- *b. False

Correct answer: b

Learning Objective 1.6 ~ Justify the demand for audit and assurance services

15. Only current investors (not potential investors) are considered to be users of the financial statements.

- a. True
- *b. False

Correct answer: b

Learning Objective 1.6 ~ Justify the demand for audit and assurance services

16. International Auditing and Assurance Standards Board (IAASB) is not responsible for the redrafting of International Auditing Standards (ISAs) to Australian Auditing Standards (ASAs).

- *a. True
- b. False

Correct answer: a

Learning Objective 1.7 ~ Compare the different regulators and regulations surrounding the assurance process

17. You must complete further study after a bachelor's degree to become a member of the CAANZ, CPA Australia or the IPA.

- *a. True
- b. False

Correct answer: a

Learning Objective 1.7 ~ Compare the different regulators and regulations surrounding the assurance process

18. The expectation gap is caused by unrealistic user expectations such as the auditor providing a moderate level of assurance.
- a. True
 - *b. False

Correct answer: b

Learning Objective 1.8 ~ Categorise the audit expectation gap

Multiple-choice questions

19. An example of the three parties in an assurance engagement would be:
- *a. audit client, supplier, auditor.
 - b. audit client, employee, customer.
 - c. auditor, general public, employees.
 - d. auditor, shareholder, general public.

Correct answer: a

Learning Objective 1.1 ~ Describe an assurance engagement

20. An assurance engagement can be defined as
- a. an engagement of an expert to direct the entity on subject matter.
 - *b. an engagement to enhance the reliability of the subject matter.
 - c. an audit to determine the validity of the subject matter.
 - d. an engagement to determine a true and fair view of the entities course of actions.

Correct answer: b

Learning Objective 1.1 ~ Describe an assurance engagement

21. Which of the following is NOT true about Corporate Social Responsibility assurance?
- a. disclosures include environmental, employee and social reporting.
 - b. includes both financial and non-financial information.
 - c. reporting is voluntary and is becoming more widespread.
 - *d. is required to be performed by an auditor.

Correct answer: d

Learning Objective 1.2 ~ Discriminate between different types of assurance services

22. A limitation of an audit is caused by
- a. the need for the audit to be conducted within a reasonable period of time and at a reasonable cost.
 - b. the nature of audit procedures.
 - c. the nature of financial reporting.
 - *d. all of the above.

Correct answer: d

Learning Objective 1.2 ~ Discriminate between different types of assurance services

23. Which of the following would be an example of a reasonable assurance engagement?
- a. the reporting of procedures performed by the auditor as agreed by the client.
 - *b. the audit of annual financial statements.
 - c. the review of annual financial statements.
 - d. all of the above.

Correct answer: b

Learning Objective 1.3 ~ Discriminate between the different levels of assurance

24. When auditors are engaged in work where no assurance is provided this means;
- *a. An assurance is not provided as the client determines the nature, timing and extent of the evidence that is gathered and will determine their own outcome.
 - b. The auditors found anomalies in the financial information and no assurance will be given until further testing is conducted.
 - c. That the review indicates adverse finding and the auditors are not prepared to give an assurance that the information gives a true and fair view.
 - d. No assurance is provided as the client will determine the outcome once the auditors have gathered the correct data.

Correct answer: a

Learning Objective 1.3 ~ Discriminate between the different levels of assurance

25. In a review engagement, which of the following is least likely to occur during the engagement?
- a. enquiries with management and other personnel.
 - b. analytical procedures.
 - c. review of the internal controls of the entity.
 - *d. substantive audit procedures.

Correct answer: d

Learning Objective 1.3 ~ Discriminate between the different levels of assurance

26. The wording of a negative expression of opinion generally states that:
- a. there is something wrong with the subject matter.
 - b. there is nothing wrong with the subject matter.
 - c. there is something that has come to the auditor's attention that would lead them to believe that the information being assured is not true and fair.
 - *d. there is nothing that has come to the auditor's attention that would lead them to believe that the information being assured is not true and fair.

Correct answer: d

Learning Objective 1.4 ~ Categorise different audit opinions

27. The following can be said about an emphasis of matter:
- a. it cannot be used when expressing audit opinion that has pervasive misstatements.
 - b. it is only used in unqualified audit opinions.
 - c. it is included when the auditors opinion has changed and the auditor wants to bring the users' attention to a particular matter.
 - *d. it is included when the auditor's opinion has not changed and the auditor wants to bring the users' attention to a particular matter.

Correct answer: d

Learning Objective 1.4 ~ Categorise different audit opinions

28. Which of the following is not a type of opinion?
- *a. modified opinion.
 - b. qualified opinion.
 - c. disclaimer of opinion.
 - d. adverse opinion.

Correct answer: a

Learning Objective 1.4 ~ Categorise different audit opinions

29. An example of an unmodified audit opinion is:
- *a. unqualified audit opinion with an emphasis of matter.
 - b. adverse audit opinion.
 - c. qualified audit opinion.
 - d. none of the above.

Correct answer: a

Learning Objective 1.4 ~ Categorise different audit opinions

30. Which of the following is not true in relation to comparability?
- a. able to assess performance of the entity over time and with other entities.
 - b. able to identify trends that may influence their perception of how well the entity is doing.
 - c. able to evaluate.
 - *d. all of the above are correct.

Correct answer: d

Learning Objective 1.5 ~ Discriminate between the different role of the preparer and the auditor, and discuss the different firms that provide assurance services

31. In addition to the preparation of financial statements, it is also the responsibility of those charged with governance to:
- a. selecting and applying appropriate accounting policies and making reasonable accounting estimates.
 - b. establish and maintain internal controls that are effective in preventing and detecting material misstatements.
 - c. identify the financial reporting framework to be used in the preparation and presentation of their financial report.
 - *d. all of the above.

Correct answer: d

Learning Objective 1.5 ~ Discriminate between the different role of the preparer and the auditor, and discuss the different firms that provide assurance services

32. Professional scepticism does not involve:
- a. being suspicious when evidence contradicts documents held by their client or enquiries made of client personnel.
 - b. seeking independent evidence to corroborate information provided by their client.
 - *c. the professional requirement that all management representations be substantiated with supporting documentation.
 - d. none of the above.

Correct answer: c

Learning Objective 1.5 ~ Discriminate between the different role of the preparer and the auditor, and discuss the different firms that provide assurance services

33. Under CLERP9, which of the following is not correct relating to specific disclosures in the directors report?
- a. if the directors are satisfied that auditor independence has not been impacted by the provision of non-audit services, a statement of the directors' reasons for being satisfied.
 - b. details of the amount paid or payable to the company's auditor for non-audit services (each non-audit service must be listed separately along with the amount paid or payable for that service).
 - c. a statement whether the directors are satisfied that the provision of non-audit services by the auditor impacts the auditor's independence.
 - *d. disclosure of material transactions between auditor and entity during the period under audit.

Correct answer: d

Learning Objective 1.5 ~ Discriminate between the different role of the preparer and the auditor, and discuss the different firms that provide assurance services

34. The largest accounting firms in Australia are known collectively as the
- a. 'Big-6'
 - *b. 'Big-4'
 - c. 'Big-3'
 - d. 'Big-5'

Correct answer: b

Learning Objective 1.5 ~ Discriminate between the different role of the preparer and the auditor, and discuss the different firms that provide assurance services

35. Which of the following is incorrect? A government can be considered to be a user of the general purpose financial reports because:
- a. it can determine whether certain regulations have been complied with.
 - *b. it is the basis for the calculation of taxes owed to the government.
 - c. to assess the entity so that it can provide the entity with grants that will benefit society.
 - d. to gain a better understanding of the entities activities.

Correct answer: b

Learning Objective 1.6 ~ Justify the demand for audit and assurance services

36. Suppliers as a user of the financial statements would least consider which of the following aspects of the financial statements:
- a. profitability of the entity.
 - b. solvency of the entity.
 - c. corporate social responsibility of the entity.
 - *d. return on investment of the entity.

Correct answer: d

Learning Objective 1.6 ~ Justify the demand for audit and assurance services

37. Insurance hypothesis tells us that:
- a. investors can insure themselves against loss by investing in a diverse investment portfolio should an individual investment fail.
 - *b. investors will demand that financial reports be audited as a way of insuring against some of their loss should their investment fail.
 - c. the entity can take out insurance to protect itself from such risks as employee or management fraud which can lead to material misstatements in the financial statements.
 - d. investors cannot insure themselves against loss when investing in an entity.

Correct answer: b

Learning Objective 1.6 ~ Justify the demand for audit and assurance services

38. Agency theory can be described as the theory of:
- *a. the relationship between the owner and the management of the business when the owner is not the manager of the business.
 - b. when the finance function is outsourced to an outside party, and the auditor is required to audit the outside party's work.
 - c. hiring an agency to review the work of the management, in this case it is the auditor.
 - d. none of the above.

Correct answer: a

Learning Objective 1.6 ~ Justify the demand for audit and assurance services

39. Which of the following is correct? The Accounting Professional Ethical Standards Board (APESB):
- a. issue technical standards to the members of the CAANZ, CPA Australia and IPA.
 - *b. standards are required to be complied with by members of each of CAANZ, CPA and IPA.
 - c. have not approved any standards that are required by law.
 - d. follows pronouncements issued by the International Accountants Ethics Standards Board (IAESB).

Correct answer: b

Learning Objective 1.7 ~ Compare the different regulators and regulations surrounding the assurance process

40. The objective of the Financial Reporting Council does not include:
- a. to monitor and report regularly on matters concerning auditor independence.
 - b. to oversee the process used for setting accounting and auditing standards.
 - c. all of the above are included in the objectives of the Financial Reporting Council.
 - *d. to be involved in the technical issues around the standard-setting process.

Correct answer: d

Learning Objective 1.7 ~ Compare the different regulators and regulations surrounding the assurance process

41. Which of the following regulators do not impact on the audit process?
- *a. Auditing Professional and Ethical Standards Board (APESB).
 - b. Institute of Public Accountants (IPA).
 - c. Australian Securities and Investments Commission (ASIC).
 - d. all of the above have an impact on the audit process.

Correct answer: a

Learning Objective 1.7 ~ Compare the different regulators and regulations surrounding the assurance process

42. The Companies and Liquidators Disciplinary Board can respond to applications made by:
- *a. the Australian Securities and Investments Commission (ASIC) or the Australian Prudential Regulation Authority (APRA).
 - b. the Australian Prudential Regulation Authority (APRA).
 - c. the Australian Securities and Investments Commission (ASIC).
 - d. the general public.

Correct answer: a

Learning Objective 1.7 ~ Compare the different regulators and regulations surrounding the assurance process

43. Which of the following is incorrect? The Australian Securities and Investments Commission (ASIC)
- *a. requires all auditors' financial statements to be independently audited annually.
 - b. registers auditors and processes annual statements from registered auditors.
 - c. enforces independence requirements for auditors.
 - d. provides a whistleblowing facility for the reporting of contraventions of the Corporations Act.

Correct answer: a

Learning Objective 1.7 ~ Compare the different regulators and regulations surrounding the assurance process

44. Auditor rotation in CLERP9 states that an auditor cannot perform a significant role in the audit of a client in more than
- a. two out of seven years.
 - b. six out of seven years.
 - *c. five out of seven years.
 - d. two out of five years.

Correct answer: c

Learning Objective 1.7 ~ Compare the different regulators and regulations surrounding the assurance process

45. The expectation gap can be reduced by:
- a. assurance providers reporting accurately the level of assurance being provided.
 - b. enhanced reporting to explain what processes have been followed in arriving at an audit or a review opinion.
 - c. auditors performing their duties properly.
 - *d. all of the above.

Correct answer: d

Learning Objective 1.8 ~ Categorise the audit expectation gap

46. The expectation gap is caused by:
- a. unrealistic auditor expectations.
 - *b. unrealistic user expectations.
 - c. realistic auditor expectations.
 - d. realistic user expectations.

Correct answer: b

Learning Objective 1.8 ~ Categorise the audit expectation gap

Short answer questions

47. The main assurance service the general public are familiar with are financial report audits. Briefly describe the other services that an auditor can provide.

Answer:

A compliance audit involves gathering evidence to ascertain whether the person or entity under review has followed the rules, policies, procedures, laws and regulations with which they must conform.

Performance audits are concerned with the economy, efficiency and effectiveness of an organisation's activities.

A comprehensive audit may encompass elements of a financial report audit, a compliance audit and a performance audit.

Internal audits are conducted to provide assurance about various aspects of an organisation's activities.

Corporate social reporting disclosures include environmental, employee and social reporting.

Learning Objective 1.2 ~ Discriminate between different types of assurance services.

48. Outline the reasons for the demand for assurance services.

Answer:

Remoteness – As most users do not have access to the entity under review, this makes it difficult to determine whether the information contained in the report is a fair presentation of the entity and its activities for the relevant period.

Complexity – Most financial report users do not have the accounting and legal knowledge to enable them to assess the complex accounting and disclosure choices being made by the entity.

Competing incentives – management may have their own incentives to present the information in a particular light which may help them achieve their own objectives. This may introduce bias in what is being presented.

Reliability – As the information is being depended upon to make important decisions, it is important that the information being presented is reliable.

Learning Objective 1.6 ~ Justify the demand for audit and assurance services.

49. How is the expectation gap caused and how can the effects expectation gap be reduced?

Answer:

In particular, the gap is caused by unrealistic user expectations such as:

- the auditor is providing complete assurance.
- the auditor is guaranteeing the future viability of the entity.
- an unqualified (clean) audit opinion is an indicator of complete accuracy.
- the auditor will definitely find any fraud.
- the auditor has checked all transactions.

The expectation gap can be reduced by:

- auditors performing their duties appropriately, complying with auditing standards and meeting the minimum standards of performance that should be expected of all auditors;
- peer reviews of audits to ensure that auditing standards have been applied correctly;
- auditing standards being reviewed and updated on a regular basis to enhance the work being done by auditors;
- education of the public.
- enhanced reporting to explain what processes have been followed in arriving at an audit (reasonable assurance) or a review (limited assurance) opinion (significant improvements have been introduced by standard setters improving assurance reporting); and
- assurance providers reporting accurately the level of assurance being provided (reasonable, limited or none).

Learning Objective 1.8 ~ Categorise the audit expectation gap.

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Essay questions

50. There have been a number of high profile corporate collapses in the past decade both in Australia and overseas. What role does society expect from auditors in ensuring this does not happen? What can auditors do to manage this expectation?