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Chapter 02

1. An example of fraudulent financial reporting is the CFO intentionally overstating sales to boost profits.
   a. True
   b. False

ANSWER: True
POINTS: 1
QUESTION TYPE: True / False
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.01 - Define the various types of fraud that affect organizations
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2. Auditors need to consider fraud arising from misappropriation of assets and fraudulent financial reporting.
   a. True
   b. False

ANSWER: True
POINTS: 1
QUESTION TYPE: True / False
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.01 - Define the various types of fraud that affect organizations
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3. Fraud is an intentional act involving the use of deception that results in a misstatement of the financial statements.
   a. True
   b. False

ANSWER: True
POINTS: 1
QUESTION TYPE: True / False
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.01 - Define the various types of fraud that affect organizations
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4. An example of fraudulent financial reporting is the treasurer's diversion of hundreds of thousands of dollars into a personal money market account.
   a. True
   b. False

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ANSWER: False
POINTS: 1
QUESTION TYPE: True / False
HAS VARIABLES: False
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5. BruceCo. has accounted for the revenue of Jiffy Mac, Inc., one of its suppliers, as though it were its subsidiary. BruceCo. has probably committed fraud because of its misapplication of consolidation principles.

a. True
b. False

ANSWER: True
POINTS: 1
QUESTION TYPE: True / False
HAS VARIABLES: False
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6. The most important lesson to be learned from The Great Salad Oil Swindle is that auditors can commit fraud by falsely including inventory that does not exist.

a. True
b. False

ANSWER: False
POINTS: 1
QUESTION TYPE: True / False
HAS VARIABLES: False
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7. A false-billing scheme is an example of the misappropriation of assets.

a. True
b. False

ANSWER: True
POINTS: 1
QUESTION TYPE: True / False

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8. An example of the misappropriation of assets is the early recognition of revenue.
   a. True
   b. False
ANSWER: False
POINTS: 1
QUESTION TYPE: True / False
HAS VARIABLES: False
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9. Opportunity is one element of the fraud triangle.
   a. True
   b. False
ANSWER: True
POINTS: 1
QUESTION TYPE: True / False
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.02 - Describe the fraud triangle and describe its three elements
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10. Rationalization involves the mindset of the fraudster to justify committing the fraud.
   a. True
   b. False
ANSWER: True
POINTS: 1
QUESTION TYPE: True / False
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.02 - Describe the fraud triangle and describe its three elements
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11. Related-party transactions provide management certain opportunities to manipulate financial statements.
    a. True
    b. False

ANSWER: True
POINTS: 1
QUESTION TYPE: True / False
HAS VARIABLES: False
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12. Pressure upon management to manipulate financial information is a common characteristic in fraud cases.
    a. True
    b. False

ANSWER: True
POINTS: 1
QUESTION TYPE: True / False
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.02 - Describe the fraud triangle and describe its three elements
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13. Management compensation that is tied to profits may create incentives to commit fraud.
    a. True
    b. False

ANSWER: True
POINTS: 1
QUESTION TYPE: True / False
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.02 - Describe the fraud triangle and describe its three elements
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14. Ineffective internal controls present an incentive for an employee to commit fraud.

a. True
b. False

ANSWER: False
POINTS: 1
QUESTION TYPE: True / False
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.02 - Describe the fraud triangle and describe its three elements
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15. An employee is short cash and needs to pay rent for the month. This need is an example of an incentive to commit fraud.

a. True
b. False

ANSWER: True
POINTS: 1
QUESTION TYPE: True / False
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.02 - Describe the fraud triangle and describe its three elements
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16. An example of rationalization is that management trusts their employees, and therefore, spend little time reviewing their work.

a. True
b. False

ANSWER: False
POINTS: 1
QUESTION TYPE: True / False
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.02 - Describe the fraud triangle and describe its three elements
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17. Management may feel pressure to maintain debt covenants, which is a deterrent to fraud.

a. True
b. False

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ANSWER: False
POINTS: 1
QUESTION TYPE: True / False
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.02 - Describe the fraud triangle and describe its three elements
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18. The auditor should not consider fraud in revenue accounts because revenue recognition does not typically play a role in fraudulent financial reporting.

a. True
b. False

ANSWER: False
POINTS: 1
QUESTION TYPE: True / False
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.03 - Review historically important frauds and discuss the implications for auditors
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19. One of the reasons auditors are required to understanding internal controls is to determine how a fraud may occur.

a. True
b. False

ANSWER: True
POINTS: 1
QUESTION TYPE: True / False
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.03 - Review historically important frauds and discuss the implications for auditors
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20. When auditors determine that there is a heightened risk of fraud, they need to immediately resign from the audit.

a. True

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b. False

ANSWER: False
POINTS: 1
QUESTION TYPE: True / False
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.03 - Review historically important frauds and discuss the implications for auditors
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21. The Holding Foreign Companies Accountable Act was passed in response to frauds perpetrated by Chinese companies that exploited loopholes in U.S. securities laws.

a. True
b. False

ANSWER: True
POINTS: 1
QUESTION TYPE: True / False
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.03 - Review historically important frauds and discuss the implications for auditors
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22. The Enron fraud in the early 2000s involved the movement of significant debt off the books to related, unconsolidated entities.

a. True
b. False

ANSWER: True
POINTS: 1
QUESTION TYPE: True / False
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.03 - Review historically important frauds and discuss the implications for auditors
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23. Since the auditor is not responsible for the presentation of financial statements; the auditor has no responsibility for fraud in the financial statements.

a. True

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b. False

ANSWER: False
POINTS: 1
QUESTION TYPE: True / False
HAS VARIABLES: False
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24. The auditor is responsible for actively considering fraud risks in order to obtain reasonable assurance that the financial statements are free of material fraud.

a. True
b. False

ANSWER: True
POINTS: 1
QUESTION TYPE: True / False
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.04 - Discuss auditors' fraud-related responsibilities- including exercising professional skepticism - and users' fraud-related expectations
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25. Fraud detection procedures should only be performed for clients that have had fraud problems in the past.

a. True
b. False

ANSWER: False
POINTS: 1
QUESTION TYPE: True / False
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.04 - Discuss auditors' fraud-related responsibilities- including exercising professional skepticism - and users' fraud-related expectations
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26. If an auditor discovers evidence of fraud, the planned audit procedures should be adjusted accordingly.

a. True
b. False

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ANSWER: True
POINTS: 1
QUESTION TYPE: True / False
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.04 - Discuss auditors' fraud-related responsibilities- including exercising professional skepticism - and users' fraud-related expectations
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27. Professional skepticism is required on audit engagements that have a high risk of fraud but can be disregarded for all other engagements.

a. True
b. False

ANSWER: False
POINTS: 1
QUESTION TYPE: True / False
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.04 - Discuss auditors' fraud-related responsibilities- including exercising professional skepticism - and users' fraud-related expectations
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28. According to professional audit standards, the audit team should assemble during the planning stages of an audit to conduct a fraud "brainstorming" meeting to discuss the possibility andt types of fraud that may occur with the client.

a. True
b. False

ANSWER: True
POINTS: 1
QUESTION TYPE: True / False
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.04 - Discuss auditors' fraud-related responsibilities- including exercising professional skepticism - and users' fraud-related expectations
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29. Once the fraud risk assessment is complete in the planning stage, the auditor need not consider fraud further.

a. True
b. False

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ANSWER: False
POINTS: 1
QUESTION TYPE: True / False
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.04 - Discuss auditors' fraud-related responsibilities- including exercising professional skepticism - and users' fraud-related expectations
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30. Audit procedures to detect fraud are generally an expansion of normal audit procedures.
    a. True
    b. False

ANSWER: False
POINTS: 1
QUESTION TYPE: True / False
HAS VARIABLES: False
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31. Auditing standards have historically reflected an expectation that auditors will detect and report every instance of material fraud.
    a. True
    b. False

ANSWER: False
POINTS: 1
QUESTION TYPE: True / False
HAS VARIABLES: False
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32. Auditors must keep a questioning mind when analyzing management responses to inquiry, and auditors should strive to obtain corroborating evidence before accepting management's responses.
    a. True
    b. False

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ANSWER: True
POINTS: 1
QUESTION TYPE: True / False
HAS VARIABLES: False
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33. The auditor must perform a brainstorming session with client management when planning the audit procedures to be performed.

a. True
b. False

ANSWER: False
POINTS: 1
QUESTION TYPE: True / False
HAS VARIABLES: False
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34. According to the PCAOB, the detection of material fraud is a reasonable expectation of users of audited financial statements.

a. True
b. False

ANSWER: True
POINTS: 1
QUESTION TYPE: True / False
HAS VARIABLES: False
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35. The audit team should develop its own ideas about how fraud may be performed by the client and then covered up.

a. True
b. False

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ANSWER: True
POINTS: 1
QUESTION TYPE: True / False
HAS VARIABLES: False
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36. Audit tests performed during the audit of the financial statements do not relate to fraud testing because testing for fraud is conducted in a separate engagement.

a. True
b. False

ANSWER: False
POINTS: 1
QUESTION TYPE: True / False
HAS VARIABLES: False
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37. When the risk of fraud is high in financial statements, the auditor should assign less experienced auditors to the engagement.

a. True
b. False

ANSWER: False
POINTS: 1
QUESTION TYPE: True / False
HAS VARIABLES: False
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38. When fraud risk is great in the organization under audit, procedures applied are likely to be more extensive.

a. True
b. False

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ANSWER: True
POINTS: 1
QUESTION TYPE: True / False
HAS VARIABLES: False
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39. Auditors are responsible to detect fraud even if it has an immaterial effect on the financial statements.
    a. True
    b. False
ANSWER: False
POINTS: 1
QUESTION TYPE: True / False
HAS VARIABLES: False
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40. The auditor has a responsibility to design the audit to provide absolute assurance of detecting material fraud.
    a. True
    b. False
ANSWER: False
POINTS: 1
QUESTION TYPE: True / False
HAS VARIABLES: False
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41. The auditor can be satisfied with less than persuasive evidence in the audit process because of the belief that management is honest.
    a. True
    b. False
ANSWER: False

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Chapter 02

POINTS: 1
QUESTION TYPE: True / False
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.04 - Discuss auditors' fraud-related responsibilities- including exercising professional skepticism - and users' fraud-related expectations
NATIONAL STANDARDS: United States - BUSPROG: Comprehension
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42. Professional skepticism involves such things as questioning and corroborating management responses to inquiries and determining the authenticity of documents.

a. True
b. False

ANSWER: True
POINTS: 1
QUESTION TYPE: True / False
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.04 - Discuss auditors' fraud-related responsibilities- including exercising professional skepticism - and users' fraud-related expectations
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43. An audit must be performed by persons who can make sound judgments relating to complex accounting issues.

a. True
b. False

ANSWER: True
POINTS: 1
QUESTION TYPE: True / False
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.04 - Discuss auditors' fraud-related responsibilities- including exercising professional skepticism - and users' fraud-related expectations
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44. The Sarbanes-Oxley Act established the PCAOB, which is an agency of the U.S. government funded by taxpayers.

a. True
b. False

ANSWER: False

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POINTS: 1
QUESTION TYPE: True / False
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.05 - Explain how various requirements in the Sarbanes-Oxley Act of 2002 help prevent fraud
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45. According to the Sarbanes-Oxley Act, the audit committee must have at least 3 independent members who are financial experts.
    a. True
    b. False
ANSWER: False
POINTS: 1
QUESTION TYPE: True / False
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.05 - Explain how various requirements in the Sarbanes-Oxley Act of 2002 help prevent fraud
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46. The audit committee is a subcommittee of the board of directors composed of independent outside directors.
    a. True
    b. False
ANSWER: True
POINTS: 1
QUESTION TYPE: True / False
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.05 - Explain how various requirements in the Sarbanes-Oxley Act of 2002 help prevent fraud
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47. Any major disagreement the auditor has with management should be discussed with the audit committee
    a. True
    b. False
ANSWER: True
POINTS: 1

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QUESTION TYPE: True / False
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.05 - Explain how various requirements in the Sarbanes-Oxley Act of 2002 help prevent fraud
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48. The audit committee must be composed of outsiders such as the organization's attorney and audit partner.
    a. True
    b. False
ANSWER: False
POINTS: 1
QUESTION TYPE: True / False
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.05 - Explain how various requirements in the Sarbanes-Oxley Act of 2002 help prevent fraud
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49. Audit committees of publicly traded companies must establish whistleblowing mechanisms within the company.
    a. True
    b. False
ANSWER: True
POINTS: 1
QUESTION TYPE: True / False
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.05 - Explain how various requirements in the Sarbanes-Oxley Act of 2002 help prevent fraud
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50. Management of companies should have the ability to hire and fire the external auditor.
    a. True
    b. False
ANSWER: False
POINTS: 1
QUESTION TYPE: True / False

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HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.05 - Explain how various requirements in the Sarbanes-Oxley Act of 2002 help prevent fraud
AUD.ZEHMS.24.02.06 - Define corporate governance, identify the parties involved, and describe their respective activities
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51. The audit committee should have the authority to hire and fire the external auditor.
a. True
b. False
ANSWER: True
POINTS: 1
QUESTION TYPE: True / False
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.05 - Explain how various requirements in the Sarbanes-Oxley Act of 2002 help prevent fraud
AUD.ZEHMS.24.02.06 - Define corporate governance, identify the parties involved, and describe their respective activities
NATIONAL STANDARDS: United States - BUSPROG: Comprehension
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52. A board of directors that is actively involved in monitoring management mitigates opportunities to commit fraud.
a. True
b. False
ANSWER: True
POINTS: 1
QUESTION TYPE: True / False
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.06 - Define corporate governance, identify the parties involved, and describe their respective activities
NATIONAL STANDARDS: United States - BUSPROG: Comprehension
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53. Effective corporate governance depends upon successful management of the company, as management has the primary responsibility for creating a culture of performance with integrity and ethical behavior.
a. True
b. False

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ANSWER: True
POINTS: 1
QUESTION TYPE: True / False
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.06 - Define corporate governance, identify the parties involved, and describe their respective activities
NATIONAL STANDARDS: United States - BUSPROG: Comprehension
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54. Transparency is a desirable, but not critical, element of effective corporate governance.
    a. True
    b. False
ANSWER: False
POINTS: 1
QUESTION TYPE: True / False
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.06 - Define corporate governance, identify the parties involved, and describe their respective activities
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55. Implementing an effective ethical environment is primarily the responsibility of the audit committee of the board of directors.
    a. True
    b. False
ANSWER: False
POINTS: 1
QUESTION TYPE: True / False
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.06 - Define corporate governance, identify the parties involved, and describe their respective activities
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56. Managers of organizations are hired by boards of directors to perform responsibilities such as the implementation of internal control.
    a. True
    b. False

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ANSWER: True
POINTS: 1
QUESTION TYPE: True / False
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.06 - Define corporate governance, identify the parties involved, and describe their respective activities
NATIONAL STANDARDS: United States - BUSPROG: Comprehension
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57. Formulating corporate strategy and risk management policy is primarily the responsibility of the board of directors.

a. True
b. False

ANSWER: False
POINTS: 1
QUESTION TYPE: True / False
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.06 - Define corporate governance, identify the parties involved, and describe their respective activities
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58. Which of the following best represents fraud related to financial reporting?

a. The transfer agent issues 40,000 shares of the company's stock to a friend without authorization by the board of directors.
b. The controller of the company decreases warranty expense by $3 million so the company will meet analysts' expectations this quarter.
c. The in-house attorney receives payments from the French government for negotiating the development of a new plant in Paris.
d. The accounts receivable clerk covers up the theft of cash receipts by writing off older receivables without authorization.

ANSWER: b
POINTS: 1
QUESTION TYPE: Multiple Choice
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.01 - Define the various types of fraud that affect organizations
NATIONAL STANDARDS: United States - BUSPROG: Comprehension
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59. According to professional auditing standards, which of the following **best** represents a type of fraudulent financial reporting?

a. Management accrues a liability and discloses the possible outcome of a lawsuit prior to settling the matter.
b. Management reclassifies a negative cash balance by decreasing cash and increasing a current liability.
c. Management discloses its failure to meet loan covenants but states that a waiver has been received.
d. Management intentionally excludes from its consolidated results a subsidiary that it controls significantly.

ANSWER: d
POINTS: 1
QUESTION TYPE: Multiple Choice
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.01 - Define the various types of fraud that affect organizations
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60. What type of fraud occurs when the deposits of current investors are used to pay returns on the deposits of previous investors with no real investment happening?

a. Ponzi Scheme.
b. Skimming.
c. Channel Stuffing.
d. Off-Balance Sheet Fraud.

ANSWER: a
POINTS: 1
QUESTION TYPE: Multiple Choice
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.01 - Define the various types of fraud that affect organizations
NATIONAL STANDARDS: United States - BUSPROG: Comprehension
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61. Which of the following represents a misappropriation of assets?

a. Polly takes $100 petty cash to purchase movie tickets for her family.
b. Max’s records defer the recognition of expenses to next fiscal year.
c. Claude omits to include note disclosure regarding a lease commitment.
d. Anne records revenue when the contract is signed.

ANSWER: a
POINTS: 1

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QUESTION TYPE: Multiple Choice
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.01 - Define the various types of fraud that affect organizations
NATIONAL STANDARDS: United States - BUSPROG: Comprehension
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62. Which of the following is an example of fraud?
    a. A mistake in processing accounting data.
    b. An incorrect accounting estimate arising from misinterpretation of facts.
    c. Misappropriation of an asset.
    d. A mistake in the application of accounting principles.

ANSWER: c
POINTS: 1
QUESTION TYPE: Multiple Choice
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.01 - Define the various types of fraud that affect organizations
NATIONAL STANDARDS: United States - BUSPROG: Comprehension
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63. What is the primary difference between fraud and errors in financial statement reporting?
    a. The materiality of the misstatement.
    b. The intent to deceive.
    c. The level of management involved.
    d. The type of transaction affected.

ANSWER: b
POINTS: 1
QUESTION TYPE: Multiple Choice
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.01 - Define the various types of fraud that affect organizations
NATIONAL STANDARDS: United States - BUSPROG: Comprehension
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64. Which of the following financial reporting frauds is most common?
    a. Chief financial officer’s misappropriation of funds.
    b. Misapplication of revenue recognition principles.
    c. Management's theft of cash held in reserve accounts.
    d. Over-recording expenses related to stock options.

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ANSWER: b
POINTS: 1
QUESTION TYPE: Multiple Choice
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.01 - Define the various types of fraud that affect organizations
AUD.ZEHMS.24.02.03 - Review historically important frauds and discuss the implications for auditors
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65. Which of the following statements about the Bernie Madoff Ponzi scheme is false?
a. Madoff took advantage of his unique ties to the investment community (he was the former Chair of the NASDAQ) to create trust and encourage further investments.
b. Madoff began perpetrating the fraud shortly before passage of the Sarbanes-Oxley Act, and the provisions of that Act ultimately led to discovery of the fraud.
c. Madoff was sentenced to 150 years in prison.
d. The estimated amount missing from client accounts, including fabricated gains, was almost $65 billion.

ANSWER: b
POINTS: 1
QUESTION TYPE: Multiple Choice
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.01 - Define the various types of fraud that affect organizations
AUD.ZEHMS.24.02.05 - Explain how various requirements in the Sarbanes-Oxley Act of 2002 help prevent fraud
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66. The fraud triangle identifies three elements that are generally present in a client's organization when fraud occurs. Which of the following is not one of those elements?
a. Professional skepticism.
b. Incentives.
c. Opportunity.
d. Rationalization.

ANSWER: a
POINTS: 1
QUESTION TYPE: Multiple Choice
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.02 - Describe the fraud triangle and describe its three elements
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67. Which of the following is a common incentive or condition that increases the likelihood of fraudulent financial reporting?

a. Ineffective segregation of assets.
b. Significant related party transactions.
c. Management bonuses based on reported earnings.
d. Access to undeposited cash.

ANSWER: c
POINTS: 1
QUESTION TYPE: Multiple Choice
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.02 - Describe the fraud triangle and describe its three elements
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68. Which of the following describes the elements of the fraud triangle?

a. Incentive, Deception, Rationalization.
b. Professional Skepticism, Opportunity, Rationalization.
c. Incentive, Opportunity, Rationalization.
d. Opportunity, Deception, Rationalization.

ANSWER: c
POINTS: 1
QUESTION TYPE: Multiple Choice
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.02 - Describe the fraud triangle and describe its three elements
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69. Management of Premium Discovery Company is compensated through large salaries, stock options, and bonuses tied to the company's working capital growth. The CEO is constantly holding meetings to ensure that management is on target and increasing operating income each month. Based on this information, which element of the fraud triangle exists at the Premium Discovery Company?

a. Incentive.
b. Opportunity.
c. Rationalization.
d. Expectation.

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ANSWER: a
POINTS: 1
QUESTION TYPE: Multiple Choice
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.02 - Describe the fraud triangle and describe its three elements
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70. Sam Jones, controller of Mitnikco, spends three days researching the accounting standards to find loopholes in the "rules" to make a case for recognizing revenue earlier, rather than later. Sam and the other members of management decide to reduce the company's deferred revenue accounts and begin accounting for all revenues as agreements are signed. Based on this information, which element of fraud is represented by the actions of Mitnikco management?

a. Pressures.
b. Opportunity.
c. Rationalization.
d. Skepticism.

ANSWER: c
POINTS: 1
QUESTION TYPE: Multiple Choice
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.02 - Describe the fraud triangle and describe its three elements
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71. Which of the following creates an opportunity for fraud to be committed in an organization?

a. Management demands financial success.
b. Poor internal control.
c. Commitments tied to debt covenants.
d. Management is aggressive in its application of accounting rules.

ANSWER: b
POINTS: 1
QUESTION TYPE: Multiple Choice
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.02 - Describe the fraud triangle and describe its three elements
NATIONAL STANDARDS: United States - BUSPROG: Comprehension
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72. The fraud triangle has three elements. Which of the following accurately describes which elements must be present for a fraud to occur?

a. All elements must be present for fraud to occur.
b. Only two of the three elements must be present for fraud to occur.
c. Fraud can occur if any one of the elements is present.
d. None of these.

ANSWER: a
POINTS: 1
QUESTION TYPE: Multiple Choice
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.02 - Describe the fraud triangle and describe its three elements
NATIONAL STANDARDS: United States - BUSPROG: Comprehension
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73. Which of the following accurately describes the impact of internal controls on the likelihood of fraud occurring?

a. Weak internal controls decrease the likelihood of fraud.
b. Strong internal controls decrease the likelihood of fraud.
c. Internal controls have no impact on the likelihood of fraud.
d. Both weak and strong internal controls decrease the likelihood of fraud.

ANSWER: b
POINTS: 1
QUESTION TYPE: Multiple Choice
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.02 - Describe the fraud triangle and describe its three elements
NATIONAL STANDARDS: United States - BUSPROG: Comprehension
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
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74. Which of the following is an incentive to commit fraud?

a. Bonus is tied to net income.
b. Cash till is left unlocked.
c. The belief that the company should pay its employees more.
d. Mandatory vacation policy.

ANSWER: a
POINTS: 1
QUESTION TYPE: Multiple Choice
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.02 - Describe the fraud triangle and describe its three elements
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75. In the technology services industry, which of the following is the most cause of fraudulent reporting?
    a. Write-off related to the impairment of assets.
    b. Increased recognition of expenses.
    c. Increase in allowance for doubtful accounts.
    d. Premature recognition of revenue.

ANSWER: d
POINTS: 1
QUESTION TYPE: Multiple Choice
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.03 - Review historically important frauds and discuss the implications for auditors
NATIONAL STANDARDS: United States - BUSPROG: Comprehension
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76. Which of the following employees is most likely to perpetrate fraud by circumventing the internal controls of the company?
    a. Human Resource Manager.
    b. Production Senior Executive.
    c. Chief Financial Operator.
    d. Sales Manager.

ANSWER: d
POINTS: 1
QUESTION TYPE: Multiple Choice
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.03 - Review historically important frauds and discuss the implications for auditors
NATIONAL STANDARDS: United States - BUSPROG: Comprehension
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77. Which of the following is more likely to exist in a company where fraud is being committed?
    a. Slowing product demand.
    b. Personnel with sufficient training.
    c. Strong management tone.
    d. Decreasing supplier costs.

ANSWER: a

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POINTS: 1
QUESTION TYPE: Multiple Choice
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.03 - Review historically important frauds and discuss the implications for auditors
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78. Which of the following actions was a key element of the Enron audit fraud?
    a. Capitalizing line costs rather than expensing them.
    b. Misrepresenting bribes from suppliers as a reduction of operating costs.
    c. Shifting debt to off-balance sheet special entities.
    d. Concealing large losses related to securities investments.

ANSWER: c
POINTS: 1
QUESTION TYPE: Multiple Choice
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.03 - Review historically important frauds and discuss the implications for auditors
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79. Which of the following frauds involved primarily asset misappropriation?
    a. Enron.
    b. WorldCom.
    c. Dell.
    d. Koss.

ANSWER: d
POINTS: 1
QUESTION TYPE: Multiple Choice
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.03 - Review historically important frauds and discuss the implications for auditors
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80. Which of the following actions was a key element in the WorldCom fraud case?
    a. Recording bartered exchange transactions as revenue.

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b. Overstating cash by falsely recording cash supposedly held at major banks.
c. Recognizing revenue on the sale of impaired assets.
d. Concealing large losses related to securities investments.

ANSWER: a
POINTS: 1
QUESTION TYPE: Multiple Choice
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.03 - Review historically important frauds and discuss the implications for auditors
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81. Which of the following actions was a key element in the Wells Fargo fraud case?
a. Inflating assets by falsely overstating cash held in customers' accounts.
b. Creating fake customer accounts to boost employees' bonuses.
c. Employee theft from customers' accounts.
d. Top management's recording of fictitious fees to increase reported revenues.

ANSWER: b
POINTS: 1
QUESTION TYPE: Multiple Choice
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.03 - Review historically important frauds and discuss the implications for auditors
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82. What is the best way for an auditor to detect fraud in the financial statements?
a. Actively search for errors in the financial statements.
b. Understand Generally Accepted Accounting Standards.
c. Brainstorm with the client to find the types of fraud occurring.
d. Use professional skepticism.

ANSWER: d
POINTS: 1
QUESTION TYPE: Multiple Choice
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.03 - Review historically important frauds and discuss the implications for auditors
AUD.ZEHMS.24.02.04 - Discuss auditors' fraud-related responsibilities- including exercising professional skepticism - and users' fraud-related expectations

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83. Which of the following best describes professional skepticism?
    a. An intent to deceive.
    b. An attitude of intrusion and obstinacy.
    c. A firm commitment to auditing standards and ethics.
    d. A questioning mind.

ANSWER: d
POINTS: 1
QUESTION TYPE: Multiple Choice
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.03 - Review historically important frauds and discuss the implications for auditors
AUD.ZEHMS.24.02.04 - Discuss auditors' fraud-related responsibilities- including exercising professional skepticism - and users' fraud-related expectations
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84. Why is material fraud detection an important consideration in the audit of financial statements?
    a. Auditors are required to seek out and find all fraud, regardless of its magnitude.
    b. Auditors expect that management will make them aware of any fraud in the financial statements.
    c. Society expects that financial statements have not been materially misstated due to fraud.
    d. Society realizes that some fraud was not intended to be discovered by auditors.

ANSWER: c
POINTS: 1
QUESTION TYPE: Multiple Choice
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.04 - Discuss auditors' fraud-related responsibilities- including exercising professional skepticism - and users' fraud-related expectations
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85. One of the primary goals of the PCAOB is to enable the investing public to have confidence in which group?
    a. The SEC.
    b. Boards of directors.
    c. Internal auditors.

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d. Independent auditors.

ANSWER: d
POINTS: 1
QUESTION TYPE: Multiple Choice
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.04 - Discuss auditors' fraud-related responsibilities- including exercising professional skepticism - and users' fraud-related expectations
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86. Which of the following statements reflects an auditor's responsibility for detecting fraud?
a. An auditor is never responsible for discovering fraudulent acts involving employee collusion.
b. The audit should be planned to detect only fraud caused by departures from GAAP.
c. An auditor is only responsible for detecting fraudulent financial reporting.
d. An auditor should design the audit to provide reasonable assurance of detecting errors and fraud that are material to the financial statements.

ANSWER: d
POINTS: 1
QUESTION TYPE: Multiple Choice
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.04 - Discuss auditors' fraud-related responsibilities- including exercising professional skepticism - and users' fraud-related expectations
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87. How must an auditor address fraud in the planning stage?
a. The auditor must test for fraud in the planning stage by sampling accounts.
b. The auditor must consider the likelihood of fraud existing in the company in the planning stage.
c. The auditor must realize that most people are honest and not automatically assume that fraud exists when planning the audit.
d. The auditor must be aggressive in its initial approach to fraud, knowing that they will lose the trust of their client.

ANSWER: b
POINTS: 1
QUESTION TYPE: Multiple Choice
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.04 - Discuss auditors' fraud-related responsibilities- including exercising professional skepticism - and users' fraud-related expectations
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88. What should an audit team do when it discovers that fraud risk factors are present on an audit engagement?
    a. Withdraw from the engagement and inform regulatory bodies.
    b. Modify procedures to actively search for the existence of fraud.
    c. Reduce the amount of evidence required and resort to management inquiry.
    d. Immediately turn the audit over to forensic accountants.

ANSWER: b
POINTS: 1
QUESTION TYPE: Multiple Choice
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.04 - Discuss auditors' fraud-related responsibilities- including exercising professional skepticism - and users' fraud-related expectations
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89. Which of the following best represents actions that may indicate financial reporting fraud is pervasive throughout the company under audit?
    a. The company's management negotiates deals with vendors in such a manner as to pay lower prices.
    b. The company's management drives luxury vehicles and takes vacations to exotic places.
    c. The company's management takes an overly aggressive approach to revenue recognition.
    d. The company's management estimates bad debts using an aged accounts receivables ledger rather than as a percent of sales.

ANSWER: c
POINTS: 1
QUESTION TYPE: Multiple Choice
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.04 - Discuss auditors' fraud-related responsibilities- including exercising professional skepticism - and users' fraud-related expectations
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90. What should auditors and others involved in the financial reporting process do to mitigate the risk of fraudulent financial reporting?
    a. Acknowledge that there needs to exist a strong, highly ethical tone at the top of an organization that permeates the corporate culture, including an effective fraud risk management program.
    b. Continually exercise professional skepticism.
    c. Remember that strong communication among those involved in the financial reporting process is critical.

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d. All of these.

ANSWER: d
POINTS: 1
QUESTION TYPE: Multiple Choice
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.04 - Discuss auditors' fraud-related responsibilities- including exercising professional skepticism - and users' fraud-related expectations
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91. There are many important reasons for diligent audit planning. If an audit firm skips the planning stage of an audit, what will be the effect relative to fraud detection?

a. The firm will not be able to apply GAAP to the financial statements.
b. The firm will not adequately identify the types of fraud that may occur in the client company.
c. The firm will not be able to perform direct tests of account balances.
d. The firm will lack the competency and technical training necessary to complete the audit in accordance with GAAS.

ANSWER: b
POINTS: 1
QUESTION TYPE: Multiple Choice
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.04 - Discuss auditors' fraud-related responsibilities- including exercising professional skepticism - and users' fraud-related expectations
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92. Which of the following statements about fraud or fraud detection is true?

a. Management may physically alter evidence to perpetrate and conceal the fraud.
b. Fraudulent financial reporting is generally not material enough to consider.
c. Journal entries will supply evidence necessary to detect fraud.
d. All new technology prevents fraud, thereby leading to less fraud over time.

ANSWER: a
POINTS: 1
QUESTION TYPE: Multiple Choice
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.04 - Discuss auditors' fraud-related responsibilities- including exercising professional skepticism - and users' fraud-related expectations
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93. Which of the following factors should an auditor consider in evaluating the effect of fraud upon the planned audit procedures?

a. The type of fraud that may occur.
b. The potential materiality of fraud.
c. The likelihood of fraud occurring.
d. All of these.

ANSWER: d
POINTS: 1
QUESTION TYPE: Multiple Choice
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.04 - Discuss auditors' fraud-related responsibilities- including exercising professional skepticism - and users' fraud-related expectations
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94. How did the Sarbanes-Oxley Act strengthen auditor independence?

a. By requiring auditors to provide reports in accordance with the Foreign Corrupt Practices Act.
b. By requiring auditors to report the nature of any auditor-client disagreements to the SEC.
c. By requiring the lead partner to rotate off the audit engagement at least every five years.
d. By requiring a different audit firm from the one that performs the audit to prepare the client's tax return.

ANSWER: c
POINTS: 1
QUESTION TYPE: Multiple Choice
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.05 - Explain how various requirements in the Sarbanes-Oxley Act of 2002 help prevent fraud
NATIONAL STANDARDS: United States - BUSPROG: Comprehension
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95. How frequently does the PCAOB inspect registered accounting firms that audit 100 or more issuers?

a. Annually.
b. Every two years.
c. Every three years
d. Every five years.

ANSWER: a

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POINTS: 1
QUESTION TYPE: Multiple Choice
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.05 - Explain how various requirements in the Sarbanes-Oxley Act of 2002 help prevent fraud
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96. The PCAOB has how many board members?
    a. Three
    b. Five
    c. Seven
    d. Nine

ANSWER: b
POINTS: 1
QUESTION TYPE: Multiple Choice
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.05 - Explain how various requirements in the Sarbanes-Oxley Act of 2002 help prevent fraud
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97. Which of the following is a responsibility of the PCAOB?
    a. To set financial reporting standards for public companies.
    b. To set financial reporting standards for private companies.
    c. To set audit standards for public companies.
    d. To set audit standards for private companies.

ANSWER: c
POINTS: 1
QUESTION TYPE: Multiple Choice
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.05 - Explain how various requirements in the Sarbanes-Oxley Act of 2002 help prevent fraud
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98. How often does the PCAOB inspect registered accounting firms that audit fewer than 100 issuers?
    a. Annually.

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b. Every two years.
c. Every three years.
d. Every five years.

ANSWER: c
POINTS: 1
QUESTION TYPE: Multiple Choice
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.05 - Explain how various requirements in the Sarbanes-Oxley Act of 2002 help prevent fraud
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99. According to the Sarbanes-Oxley Act, which of the following items is the independent auditor required to report to the audit committee?

a. Audit procedures performed to detect fraud.
b. Critical accounting policies and practices.
c. The extent of audit testing in high-risk accounts.
d. A list of probable fraud errors identified in audit planning.

ANSWER: b
POINTS: 1
QUESTION TYPE: Multiple Choice
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.05 - Explain how various requirements in the Sarbanes-Oxley Act of 2002 help prevent fraud
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100. Under the Sarbanes-Oxley Act, which of the following services can registered accounting firms perform for their audit clients without impairing their independence?

a. Systems design.
b. Tax services.
c. Appraisal services.
d. Internal audit services.

ANSWER: b
POINTS: 1
QUESTION TYPE: Multiple Choice
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.05 - Explain how various requirements in the Sarbanes-Oxley Act of 2002 help prevent fraud

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101. Which of the following items are registered audit firms not required to report to the audit committee?
   a. Critical accounting policies and practices.
   b. Alternative treatments of financial information within generally accepted accounting principles that have been considered by management, as well as the preferred treatment of the audit firm.
   c. A list of all audit procedures performed.
   d. Significant written communications between the audit firm and management.

ANSWER: c
POINTS: 1
QUESTION TYPE: Multiple Choice
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.05 - Explain how various requirements in the Sarbanes-Oxley Act of 2002 help prevent fraud
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102. Which of the following is the responsibility of the PCAOB under the Sarbanes-Oxley Act of 2002?
   a. Certify that reports filed with the SEC do not contain untrue statements of material facts.
   b. Disclose material deficiencies in controls to the audit committee.
   c. Design internal controls.
   d. Inspect registered accounting firms.

ANSWER: d
POINTS: 1
QUESTION TYPE: Multiple Choice
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.05 - Explain how various requirements in the Sarbanes-Oxley Act of 2002 help prevent fraud
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103. Which of the following is a stated principle of a NYSE report identifying key core governance principles?
   a. The board of directors should consist of an equal number of independent and non-independent directors.
   b. Effective corporate governance should be viewed as a compliance obligation.
   c. Effective corporate governance should be integrated with the company's business strategy.

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d. The board of directors has the primary responsibility for creating a culture of integrity and ethical behavior.

ANSWER: c
POINTS: 1
QUESTION TYPE: Multiple Choice
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.06 - Define corporate governance, identify the parties involved, and describe their respective activities
NATIONAL STANDARDS: United States - BUSPROG: Comprehension
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104. Which of the following is a specific corporate governance responsibility of executive management?

a. Declaring dividends.
b. Approving non-audit work performed by the audit firm.
c. Reviewing the budget of the internal audit function.
d. Implementing an effective ethical environment.

ANSWER: d
POINTS: 1
QUESTION TYPE: Multiple Choice
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.06 - Define corporate governance, identify the parties involved, and describe their respective activities
NATIONAL STANDARDS: United States - BUSPROG: Comprehension
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105. Which of the following is a specific governance responsibility of the board of directors of a public corporation?

a. Managing and reviewing operations.
b. Approving corporate strategy.
c. Interpreting accounting standards.
d. Establishing auditing standards.

ANSWER: b
POINTS: 1
QUESTION TYPE: Multiple Choice
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.06 - Define corporate governance, identify the parties involved, and describe their respective activities
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106. Protection Transparency, Inc. is being audited by Messer and Bromely, LLP. During the fraud risk assessment, Messer and Bromely discover that the controller has been creating fictional sales and posting them to the general ledger. Who should the auditors make aware of this issue?

a. The chairman of Protection Transparency's audit committee.
b. The local police.
c. Protection Transparency's legal counsel.
d. The predecessor auditor of Protection Transparency.

ANSWER: a
POINTS: 1
QUESTION TYPE: Multiple Choice
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.06 - Define corporate governance, identify the parties involved, and describe their respective activities
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107. Which of the following is a NYSE mandated guideline for corporate governance?

a. Boards need to consist entirely of independent directors.
b. Boards must have an audit committee with a minimum of three independent directors.
c. Boards must have a compensation committee with a minimum of three dependent directors.
d. CFOs must provide an annual certification of compliance with corporate governance standards.

ANSWER: b
POINTS: 1
QUESTION TYPE: Multiple Choice
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.06 - Define corporate governance, identify the parties involved, and describe their respective activities
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108. Which of the following best describes how corporate governance influences an organization?

a. By exerting control over management.
b. By holding external auditors accountable for their actions.
c. By exerting control and requiring accountability for the resources entrusted to the organization.
d. By exerting control over the internal control environment.

ANSWER: c

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POINTS: 1
QUESTION TYPE: Multiple Choice
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.06 - Define corporate governance, identify the parties involved, and describe their respective activities
NATIONAL STANDARDS: United States - BUSPROG: Comprehension
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109. Who is responsible for operating an enterprise?
    a. The auditor.
    b. The audit committee.
    c. Management.
    d. The board of directors.

ANSWER: c
POINTS: 1
QUESTION TYPE: Multiple Choice
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.06 - Define corporate governance, identify the parties involved, and describe their respective activities
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110. Which of the following is not a specific responsibility of an audit committee as mandated by the NYSE?
    a. Discussing the company's financial statements with the external auditor.
    b. Selecting the external audit firm.
    c. Creating and implementing internal controls.
    d. Discussing financial information provided to analysts.

ANSWER: c
POINTS: 1
QUESTION TYPE: Multiple Choice
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.06 - Define corporate governance, identify the parties involved, and describe their respective activities
NATIONAL STANDARDS: United States - BUSPROG: Comprehension
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111. Which of the following describes the responsibility of the audit committee's oversight?
    a. Provide oversight of reporting outside the organization.

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b. Provide oversight of the internal auditing function.
c. Provide oversight of the external audit.
d. All of these.

ANSWER: d
POINTS: 1
QUESTION TYPE: Multiple Choice
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.06 - Define corporate governance, identify the parties involved, and describe their respective activities
NATIONAL STANDARDS: United States - BUSPROG: Comprehension
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112. Which of the following is not one of management's responsibilities?
a. Developing financial and other reports that meet the needs of users.
b. Engaging a qualified auditor.
c. Implementing effective internal controls.
d. Implementing an effective ethical environment.

ANSWER: b
POINTS: 1
QUESTION TYPE: Multiple Choice
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.06 - Define corporate governance, identify the parties involved, and describe their respective activities
NATIONAL STANDARDS: United States - BUSPROG: Comprehension
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113. Which of the following statements accurately describes an audit committee?
a. The audit committee reports directly to the top management of a company.
b. The audit committee established the accounting standards to be followed.
c. The audit committee provides oversight to the internal audit function in a company.
d. The audit committee publishes the external audit report.

ANSWER: c
POINTS: 1
QUESTION TYPE: Multiple Choice
HAS VARIABLES: False
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.06 - Define corporate governance, identify the parties involved, and describe their respective activities
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114. **Fraudulent financial reporting**

What are three common ways in which fraudulent financial reporting takes place?

ANSWER: 1. Manipulation, falsification, or alteration of accounting records or supporting documents.
2. Misrepresentation or omission of events, transactions, or other significant information.
3. Intentional misapplication of accounting principles.
POINTS: 1
QUESTION TYPE: Essay
HAS VARIABLES: False
STUDENT ENTRY MODE: Basic
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.01 - Define the various types of fraud that affect organizations
NATIONAL STANDARDS: United States - BUSPROG: Communications
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115. **Fraud consideration by auditors**

John Beasley is interviewing with public audit firms to become an auditor. John does not believe that fraud is a "big deal" in client organizations and argues that most individuals in management of companies are "honest people." He believes that auditors are becoming too cynical.

Describe your response to John"s attitude and discuss the major types of fraud that occur in companies.

ANSWER: Audit firms have received criticism for failing to discover material frauds. Auditors have a responsibility to plan the audit to consider and detect fraud. This is accomplished partially by the auditor's use of professional skepticism. Professional skepticism is not necessarily being cynical; rather, it is performing an audit with a questioning mind. It means that the auditors will obtain persuasive evidence to corroborate management responses to inquiries and to increase the sufficiency of substantive audit evidence. Professional skepticism is exhibited in the auditor's assumption that honesty in people is not a given. Auditors must not only go beyond the evidence in front of them, they must have the mindset of the possibility of fraud in all financial statement engagements.
It must also be mentioned that John's perspective will likely not be acceptable to the audit firm because his attitude toward fraud is not rigorous enough for the profession. John must realize that fraud in organizations usually takes place in one of two areas:
(1) Asset misappropriation, such as the theft and misuse of assets.
(2) Fraudulent financial reporting, such as the overstatement of certain assets and revenues and the understatement of certain liabilities and expenses.
POINTS: 1
QUESTION TYPE: Essay

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HAS VARIABLES: False
STUDENT ENTRY MODE: Basic
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.01 - Define the various types of fraud that affect organizations
AUD.ZEHMS.24.02.04 - Discuss auditors' fraud-related responsibilities- including exercising professional skepticism - and users' fraud-related expectations
NATIONAL STANDARDS: United States - BUSPROG: Communications
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116. **Elements of Fraud**
Research consistently shows that there are three elements associated with most frauds. List these elements and list at least three indicators that the element may exist for a particular company.
ANSWER: The three elements of fraud, or the fraud triangle, are incentive, opportunity, and rationalization. Following are some examples of indicators that these elements may exist for a company.
Incentives:
--Management compensation schemes
--Pressure to improve earnings or to improve the balance sheet
--Personal financial problems
--Required compliance with debt covenants
Opportunities:
--Ineffective or nonexistent internal controls
--Complex or difficult to understand transactions (including SPEs)
--Ineffective monitoring by management
--Significant related-party transactions
--Company's ability to dictate terms to suppliers or customers
--Management's inconsistency involving subject judgments regarding assets or accounting estimates
--Management's aggressiveness in applying accounting rules
Rationalization:
--This is necessary to save the company
--This is a one-time thing to get us through the current crisis
--Everybody cheats a little on the financial statements
--We will violate our debt covenants unless we find a way to improve the financial statements
--The company doesn't pay me what I'm worth
POINTS: 1
QUESTION TYPE: Essay
HAS VARIABLES: False
STUDENT ENTRY MODE: Basic
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.02 - Describe the fraud triangle and describe its three elements
NATIONAL STANDARDS: United States - BUSPROG: Communications
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117. **Enron: A Fraud Example**
What were the failures that allowed the Enron fraud to occur?

ANSWER:

Weak Management Accountability. Management was virtually not accountable to anyone as long as the company showed dramatic stock increases justified by earnings growth.
Management Accountability. Management was virtually not accountable to anyone as long as the company showed dramatic stock increases justified by earnings growth. Company management had a 'good story,' and anyone who questioned them was viewed as being stupid.
Incompetent Corporate Governance. Although the board appeared to be independent, most of the board members had close ties to management of the company through philanthropic organizations.
Accounting Rules. Accounting became more rule-oriented and complex. Accountants used obscure pronouncements, such as those dealing with Special Purpose Entities that were designed for leasing transactions, and applied the pronouncements to other entities for which such accounting was never intended.
Enthusiastic Financial Analyst Community. Financial analysts that were riding the bubble of the dot-com economy concluded they did not have tools to appropriately value many of the emerging companies.
Biased Banking and Investment Banking. Many large financial institutions were willing participants in the process because they were rewarded with large underwriting fees for other Enron work.
Lack of an Independent External Auditor. At the time of Enron, the largest five external auditing firms referred to themselves as professional service firms with diverse lines of business. All of the firms had large consulting practices. Arthur Andersen performed internal audit work for Enron, in addition to performing the external audit. The consulting fees of many clients dramatically exceeded the audit fees. Partners were compensated on revenue and profitability. Worse yet, auditors were hired by management who sometimes succeeded in pressuring auditors to acquiesce to aggressive financial reporting preferences.

POINTS: 1
QUESTION TYPE: Essay
HAS VARIABLES: False
STUDENT ENTRY MODE: Basic
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.03 - Review historically important frauds and discuss the implications for auditors
NATIONAL STANDARDS: United States - BUSPROG: Communications
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118. **Consideration of fraud in an audit**
Auditors are required to actively conduct a financial statement audit with the mindset that fraud may exist. What is the general process that an auditor goes through to assess the risk of fraud and test accordingly?

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ANSWER:

1. Understand the nature of fraud, the motivations to commit fraud, and the manner in which fraud may be perpetrated.
2. Exercise “professional skepticism” throughout the entire fraud risk assessment process.
3. “Brainstorm” and share knowledge with other audit team members.
4. Obtain information useful in identifying and assessing fraud risk.
5. Identify the specific fraud risks, including potential magnitude, and areas likely to be affected by a fraud.
6. Evaluate the quality of the company’s internal controls and potential effectiveness in mitigating the risk of fraud.
7. Respond by adjusting audit procedures to assure that the audit adequately addresses the risk of fraud and provides evidence specifically related to the possibility of fraud.
8. Evaluate findings. If evidence signals that a fraud might exist, determine whether or not forensic or specialist auditors are needed to complete the investigation.
9. Communicate the possibility that fraud exists to management, or to the audit committee or the full board if the fraud is material and/or involves members of management.
10. Document the audit approach and any findings.

POINTS: 1
QUESTION TYPE: Essay
HAS VARIABLES: False
STUDENT ENTRY MODE: Basic
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.04 - Discuss auditors’ fraud-related responsibilities- including exercising professional skepticism - and users’ fraud-related expectations
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119. **Auditor’s response to fraud risk factors**
The auditor assesses the identified fraud risks after taking into account an evaluation of the client’s programs and controls. How might the auditor respond to the results of the assessment of higher fraud risk?

ANSWER: The auditor should consider:

-Professional skepticism
a) Obtain more reliable evidence
b) Obtain additional corroborating evidence.
-Assignment of personnel and supervision--specialists or more experienced personnel
-More careful consideration of management’s selection and application of accounting principles
-Adding an element of unpredictability to auditing procedures

The auditor may change the nature, timing and extent of the audit procedures to be performed by increasing the extent of procedures, making them more persuasive, and moving more of them to the balance sheet date or later.
The response may involve the performance of procedures to further consider the risk

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related to:

a) Revenue recognition
b) Inventory quantities
c) Management estimates

Responses to consider the risk of management override of controls may include:

a) Examine journal entries and other adjustments made in preparation of financial statements
b) Review accounting estimates for biases
c) Evaluate business rationale for significant unusual transactions

POINTS: 1
QUESTION TYPE: Essay
HAS VARIABLES: False
STUDENT ENTRY MODE: Basic
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.04 - Discuss auditors' fraud-related responsibilities- including exercising professional skepticism - and users' fraud-related expectations
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120. **Auditor independence under the Sarbanes-Oxley Act**
There are a number of requirements under Sarbanes-Oxley Act that seek to protect auditor independence? Discuss four of these requirements.

ANSWER: Sarbanes-Oxley: Auditor Independence

201 Services outside the scope of practice of auditors. There exist a variety of services that registered audit firms may not perform for issuers, such as bookkeeping, systems design, appraisal services,
and internal auditing, among others. Tax services may be performed, but only with pre-approval by the audit committee.

202 Preapproval requirements. All audit and non-audit services (with certain exceptions based on size and practicality) must be approved by the audit committee of the issuer.

203 Audit partner rotation. The lead partner and reviewing partner must rotate off the issuer engagement at least every five years.

204 Auditor reports to audit committees. Registered audit firms must report to the audit committee issues concerning:

• Critical accounting policies and practices
• Alternative treatments of financial information within generally accepted accounting principles that have been considered by management, as well as the preferred treatment of the audit firm
• Significant written communications between the audit firm and management

205 Conforming amendments. This section details minor wording changes between the Sarbanes-Oxley Act and the Securities Act of 1934.

206 Conflicts of interest. Registered audit firms may not perform audits for an issuer whose CEO, CFO, controller, chief accounting officer, or other equivalent position was employed by the audit firm during the one-year period preceding the audit. This is known as a "cooling off period."

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207 Study of mandatory rotation of registered public accounting firms. The Comptroller General of the United States shall conduct a study addressing this issue.

POINTS: 1
QUESTION TYPE: Essay
HAS VARIABLES: False
STUDENT ENTRY MODE: Basic
LEARNING OBJECTIVES: AUD.ZEHMS.24.02.05 - Explain how various requirements in the Sarbanes-Oxley Act of 2002 help prevent fraud
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121. **Audit Committee Responsibilities**
Describe the responsibilities of audit committees and list at least four responsibilities that the NYSE has mandated for audit committees.

ANSWER: Section 301 of the Sarbanes-Oxley Act outlines the responsibilities of audit committee members for publicly traded companies, stating that audit committees are to be directly responsible for the appointment, compensation, and oversight of the work of registered accounting firms; they must be independent; they must establish "whistleblowing" mechanisms within the company; they must have the authority to engage their own independent counsel; and companies must provide adequate funding for audit committees.
In addition to these broad responsibilities, the NYSE has mandated certain specific responsibilities of audit committees, including:
· Obtaining an annual report by the external auditor that addresses the company's internal control procedures, any quality control or regulatory problems, and any relationships that might threaten the independence of the external auditor,
· Discussing the company's financial statements with management and the external auditor,
· Discussing in its meetings the company's earnings press releases, as well as financial information and earnings guidance provided to analysts,
· Discussing in its meetings policies with respect to risk assessment and risk management,
· Meeting separately with management, internal auditors, and the external auditor on a periodic basis,
· Reviewing with the external auditor any audit problems or difficulties that they have had with management,
· Setting clear hiring policies for employees or former employees of the external auditors, and
· Reporting regularly to the board of directors.
In addition to these responsibilities, in many companies the audit committee also has the authority to hire and fire the head of the internal audit function, set the budget for the internal audit activity, review the internal audit plan, and discuss all significant internal audit results. Other responsibilities might include performing or supervising special investigations, reviewing policies on sensitive payments, and coordinating

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	periodic reviews of compliance with company policies such as corporate governance policies.
POINTS:	1
QUESTION TYPE:	Essay
HAS VARIABLES:	False
STUDENT ENTRY MODE:	Basic
LEARNING OBJECTIVES:	AUD.ZEHMS.24.02.05 - Explain how various requirements in the Sarbanes-Oxley Act of 2002 help prevent fraud AUD.ZEHMS.24.02.06 - Define corporate governance, identify the parties involved, and describe their respective activities
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