Audit and Assurance Services 1st edition Leung Test Bank

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by

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Chapter 2: Governance and the auditor

Multiple-choice questions

1. Governance is a concept that can be applied to:

    a. not-for-profit organisations.
    b. the public sector.
    c. corporations.
    *d. all of the above.

The correct option is d.
Learning objective 2.1 ~ describe the nature of governance.

2. The conformance aspect of enterprise governance covers all these issues except:

    a. the roles of the chair of the board and top management.
    *b. resource use.
    c. internal control structures.
    d. the adequacy and reasonableness of compensation schemes for executives.

The correct option is b.
Learning objective 2.4 ~ understand the roles of internal and operational audits in the governance processes.

3. The statement that best describes internal auditing is:

    a. an activity to reduce risk.
    b. an activity located within an entity, primarily to detect fraud.
    *c. an independent and objective assurance activity within an entity.
    d. an accounting function located within an entity.

The correct option is c.
Learning objective 2.4 ~ understand the roles of internal and operational audits in the governance processes.

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4. The key benefit to management of there being an internal audit function is that:

    a. It provides assurance to management that the organisation is complying with its legal requirements.
    b. External audit costs are reduced.
    c. It provides assurance to management that fraudulent activities will be detected.
    *d. It aids management in the areas of risk management, control and governance processes.

The correct option is d.
Learning objective 2.4 ~ understand the roles of internal and operational audits in the governance processes.

5. The types of operational audit reports issued by an internal auditor are:

    a. financial report or compliance report.
    *b. varied, and are based on auditor judgment of how best to present the findings.
    c. examination report, review report or compilation report.
    d. unqualified, qualified, adverse or a disclaimer of opinion.

The correct option is b.
Learning objective 2.4 ~ understand the roles of internal and operational audits in the governance processes.

6. Whose role is it to assist management to improve operational efficiency and effectiveness by monitoring the internal control and risk management systems?

    a. The audit committee.
    b. The external auditors.
    *c. The internal auditors.
    d. All of the above.

The correct option is c.
Learning objective 2.4 ~ understand the roles of internal and operational audits in the governance processes.

7. Earnings management occurs when:
    a. income and expenses are managed to influence the performance of the entity.
    *b. financial statements and transactions are manipulated to influence perceptions about the entity.
    c. executive salaries are increased surreptitiously by including the raises in late night meetings.
    d. earnings are manipulated to improve the company's tax position.

The correct option is b.
Learning objective 2.3 ~ discuss the issues of internal control, risks and earnings management in governance that concern the auditor.

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8. Incentives for earnings management are inherent in the management structure but are least likely to originate from:

    a. executive remunerations.
    b. situations including financial distress.
    c. political considerations.
    *d. high positive cash flows.

The correct option is d.
Learning objective 2.3 ~ discuss the issues of internal control, risks and earnings management in governance that concern the auditor.

9. The COSO enterprise risk management integrated framework covers five components of internal control. Which of the following is not a component?

    a. Governance and culture.
    b. Strategy and objective-setting.
    c. Performance.
    *d. Risk management.

The correct option is d.
Learning objective 2.3 ~ discuss the issues of internal control, risks and earnings management in governance that concern the auditor.

10. Operational auditing:

    a. refers to an entity's financial operations.
    b. is historical in focus.
    *c. has a main purpose of helping management to improve the entity's effectiveness and efficiency.
    d. all of the above are correct.

The correct option is c.
Learning objective 2.4 ~ understand the roles of internal and operational audits in the governance processes.

11. The approach that has been suggested for operational audits is:
    a. the risk based audit approach.
    b. the value-for-money audit approach.
    c. the process audit approach.
    *d. all three of the above approaches have been suggested for operational audits.

The correct option is d.
Learning objective 2.4 ~ understand the roles of internal and operational audits in the governance processes.

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12. Which of these is not one of the key trends in internal auditing as identified by the 2017 PricewaterhouseCoopers study?

    a. A lack of alignment in views on the criticality and management of risks between management, the board and the internal audit.
    b. The foundational capabilities of many internal audit functions are not strong enough to add sufficient value in today's areas of risk.
    *c. Fewer younger people entering the audit profession.
    d. Internal audit does not have adequate tools to analyse business disruption or recommend resolution.

The correct option is c.
Learning objective 2.4 ~ understand the roles of internal and operational audits in the governance processes.

13. The SEC proposal on audit committees did not require:

    a. the audit committee to be directly responsible for the hiring of an independent auditor.
    b. the audit committee to be directly responsible for the oversight of an independent auditor.
    *c. the audit committee to be directly responsible for the internal auditor.
    d. the names of the committee members to be disclosed in the annual report.

The correct option is c.
Learning objective 2.5 ~ explain the significance of the role of the audit committee in governance.

14. The Australian Stock Exchange (ASX) listing rules require an audit committee to be established by:

    *a. all companies on the S&P/ASX All Ordinaries Index.
    b. all companies on the S&P/ASX 500 Index.
    c. all companies on the S&P/ASX 300 Index.
    d. all companies.

The correct option is a.
Learning objective 2.5 ~ explain the significance of the role of the audit committee in governance.

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15. The best practice recommendations for audit committees states that the audit committee should consist of:

*a. at least one member with financial expertise.
b. both executive and non-executive directors.
c. at least one independent director.
d. at least five members.

The correct option is a.
Learning objective 2.5 ~ explain the significance of the role of the audit committee in governance.

16. The audit committee should report to the board of directors on which of these matters?

a. The use of experts by the independent auditor.
*b. Recommendations for the appointment or removal of an auditor.
c. Audit procedures carried out by the independent auditor.
d. All of the above.

The correct option is b.
Learning objective 2.5 ~ explain the significance of the role of the audit committee in governance.

17. An effective audit committee:

a. improves the credibility and objectivity of the accountability process.
b. assists the directors in discharging their responsibilities with due care, diligence and skill.
c. fosters an ethical culture throughout the organisation.
*d. all of the above.

The correct option is d.
Learning objective 2.5 ~ explain the significance of the role of the audit committee in governance.

18. The Auditor General has a legislative mandate to:

a. audit the financial statement of all entities controlled by the government except government business enterprises.
b. conduct a performance audit of all government agencies, authorities and companies other than government business enterprises.
*c. audit the financial statement of all entities controlled by the government.
d. a and b.

The correct option is c.
Learning objective 2.6 ~ describe the nature of governance and the type of audits in the public sector.

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19. Which of these is a type of public sector performance audit?

a. Audit of a program or activity in a single entity.
b. Cross-entity audit, reviewing the same activity in a number of entities.
c. Audits of one or more Commonwealth partners.
*d. All of the above are types of public sector performance audits.

The correct option is d.
Learning objective 2.6 ~ describe the nature of governance and the type of audits in the public sector.

20. The Australian National Audit Office (ANAO) reports directly to:

*a. the Commonwealth Parliament.
b. the ASIC.
c. the Commonwealth Parliament.
d. the ATO.

The correct option is a.
Learning objective 2.6 ~ describe the nature of governance and the type of audits in the public sector.

21. Which of these is not a function of the Australian National Audit Office (ANAO)?

a. Auditing the statements of government bodies.
b. Carrying out performance audits.
*c. Commenting on government policy.
d. All are functions of the ANAO.

The correct option is c.
Learning objective 2.6 ~ describe the nature of governance and the type of audits in the public sector.

22. The Joint Committee of Public Accounts and Audit (JCPAA) is not charged with:

a. inquiring into matters raised by the auditor-general and referred to it by the houses of Parliament.
b. examining the accounts of the receipts and expenditure of the Australian government.
c. examining the financial affairs of Australian government authorities.
*d. reporting to the Prime Minister.

The correct answer is d.
Learning objective 2.6 ~ describe the nature of governance and the type of audits in the public sector.

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23. The independence of the Auditor General is:

a. approved by the Governor General.
b. assured by the houses of Parliament.
*c. prescribed by the *Auditor General Act 1997 (Cwlth)*.
d. prescribed by the Australian Constitution.

The correct option is c.
Learning objective 2.6 ~ describe the nature of governance and the type of audits in the public sector.

24. The Auditor General is appointed by:

a. the Parliament.
b. the Prime Minister.
c. the Joint Committee of Public Accounts and Audit.
*d. the Governor General on the recommendation of the responsible minister.

The correct option is d.
Learning objective 2.6 ~ describe the nature of governance and the type of audits in the public sector.

25. The Auditor General's powers to gather information are legislated. These powers do <u>not</u> include the power to:

*a. access private property.
b. direct a person to provide any information.
c. obtain information under oath.
d. all of the above are legislated powers of the Auditor General.

The correct option is a.
Learning objective 2.6 ~ describe the nature of governance and the type of audits in the public sector.

26. The Auditor General must report on an exception basis if:

a. proper accounting records have been kept.
b. all the necessary information and explanations were obtained.
c. records have been retained for at least 10 years.
*d. records have not been made available for inspection.

The correct option is d.
Learning objective 2.6 ~ describe the nature of governance and the type of audits in the public sector.

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27. For consolidated financial statements, the Auditor General must report:

*a. the name of a subsidiary for which he/she has not acted as an auditor.
b. the name of a subsidiary for which the financial statements have not been qualified.
c. the procedures and methods used in arriving at amounts for consolidations.
d. all of the above.

The correct option is a.
Learning objective 2.6 ~ describe the nature of governance and the type of audits in the public sector.

28. What type of auditing helps management to improve effectiveness, efficiency and economy?

a. Functional auditing.
*b. Operational auditing.
c. Financial statement auditing.
d. Performance auditing.

The correct option is b.
Learning objective 2.6 ~ describe the nature of governance and the type of audits in the public sector.

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Short answer questions

29. Describe the two sides of the enterprise governance framework.

Correct answer:
Enterprise governance comprises on one side, the corporate governance concept of conformance and assurance and on the other the strategic direction concept of performance and resource use.

The conformance aspect is based mainly on corporate governance best practice and covers issues such as:

- The roles of the chair of the board and top management to ensure accountability and independence.
- The composition, skills base, remuneration and training of the board and its committees, such as the roles of the non-executive directors.
- The adequacy and reasonableness of compensation schemes for executives.
- Internal control structures, risk management, and the role of internal audit.
- The financial reporting and disclosure regime.
- The independence of the audit function and the reporting mechanisms.

The conformance aspect is directly related to the role of the auditor, in that the audit function provides the verifiability, assurance of compliance and accountability of the organisation.

The performance dimension refers to the different tools and practices that are applied to enhance the value of the organisation. It includes setting strategic directions, comprehending and managing risk, and the key drivers of performance and decision-making processes. Auditing and assurance services can add significant value to the organisation particularly through the identification of risks and the assessment of risk management processes, or through due diligence audit and assurances.

Reference: Learning objective 2.1 ~ describe the nature of governance.

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30. Describe the essential components of enterprise risk management (ERM) as put forward by the Committee of Sponsoring Organisations of the Treadway Commission (COSO).

Correct answer:
The COSO framework for ERM consists of five interrelated components derived from the way management runs a business.

1. Governance and culture: the board of directors provides oversight and supports management in achieving strategy and business objectives by establishing operating structures in pursuit of such strategy and object gives. the organisation specifies the desired ethical behaviours and demonstrates a commitment to their core values by building human capital aligned with the entity's strategy and business objectives.
2. Strategy and objective-setting: ERM, strategy and objective-setting are intertwined in the strategic-planning process. The desired level of risk is established and aligned with strategy and operationalised through business objectives which identify, assess and respond to risk.
3. Performance: the organisation identifies risks likely to impact on the performance of strategy and business objectives, assesses the severity of risk, prioritises risks, identifies and selects risk responses, and develops and evaluates a portfolio view of risk.
4. Review and revision: the organisation identifies and assesses changes likely to substantially affect strategy and business objectives by reviewing performance and considering risk in order to improve ERM.
5. Information, communication, and reporting: the organisation leverages the entity's information and technology systems to support ERM by using communication channels to report on risk, culture and performance at multiple levels including access the entity.

The assessment of inherent and control risks can be helped by the ERM framework.

Reference: Learning objective 2.3 ~ discuss the issues of internal control, risks and earnings management in governance that concern the auditor.

31.

1. What is meant by the term Earnings Management?
2. Why has the focus on earnings management increased in recent years?
3. What incentives might there be for companies to engage in earnings management?

Correct answer:

1. Earnings management is when financial statements and transactions are manipulated in order to influence people's perceptions about the performance of the company, with the aim of showing a desirable outcome rather than the economic substance. Extreme cases can amount to fraud.
2. Failed companies such as Enron and WorldCom used earnings management techniques, and so have increased the focus.
3. Incentives can be inherent in the management structure and may include political considerations, executive remuneration, the ambiguity and inability of accounting standards to deal with complex transactions, or situations including financial distress or related party transactions.

Reference: Learning objective 2.3 ~ discuss the issues of internal control, risks and earnings management in governance that concern the auditor.

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32. What are the main objectives of the audit committee? Companies listed on the S&P/ASX All Ordinaries Index are subject to a listing rule obliging them to have an audit committee. What does the ASX suggest should be the makeup of an audit committee?

Correct answer:
The main objectives include:

- Assisting the directors in discharging their responsibilities with due care, diligence and skill
- Improving the credibility and objectivity of the accountability process
- Improving the effectiveness of the internal and external audit functions and providing an objective forum for improving communication between the board and the internal and external auditors
- Facilitating the independence of the internal and external auditors
- Strengthening the role and influence of the non-executive directors
- Fostering an ethical culture throughout the organisation.

The ASX suggests that an audit committee should consist of only non-executive directors, a majority of independent directors and an independent chairperson, who is not the chairperson of the board, members who are all financially literate, at least one member with financial expertise and some members who have an understanding of the industry.

Reference: Learning objective 2.5 ~ explain the significance of the role of the audit committee in governance.

33. What is the objective of a performance audit of a public-sector entity?

Correct answer:
To provide the parliament with assurance relating to the administration of government programs and to assist public sector managers by identifying and promoting better administrative and management practices.

Reference: Learning objective 2.6 ~ describe the nature of governance and the type of audits in the public sector.

34. How has the role of the internal auditor changed since the advent of the Sarbanes-Oxley Act in the USA in 2002?

Correct answer:
Prior to 2002, most internal auditors used a risk-based approach to performing a range of audits of controls over operational effectiveness, compliance with applicable laws and regulations and the integrity of financial reporting. Value was added by identifying areas of operational improvement as well as opportunities to improve controls and reduce risk. With the introduction of the Sarbanes-Oxley Act, many internal auditors shifted their work to a compliance driven controls focus. In addition to focusing on financial reporting compliance, internal auditors had to also cover a wider range of risks, including fraud, major programs, contracts and transactions. Internal auditors are also charged with improving their organisation's overall performance.

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Reference: Learning objective 2.4 ~ understand the roles of internal and operational audits in the governance processes.

35. What is the definition of internal auditing put forward by the Institute of Internal Auditors? Discuss the key components of the definition.

Correct answer:
The definition of internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organisation's operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, governance and control processes.

The key parts of the definition are as follows: 'Internal' indicates that the auditing is carried on within an organisation by employees of the organisation or by personnel contracted for that purpose. 'Independent and objective' suggests that internal auditing is an activity carried out without bias or prejudice with unrestricted access to people, records, facilities and products. 'Assurance and consulting activity designed to add value and improve operations' notes that the internal auditing function provides a certain level of assurance for subject matters that assist in better management decisions and operations. 'A systematic, disciplined approach to evaluate and improve the effectiveness of risk management, governance and control processes' refers to the structure and approach of internal auditing. The nature of internal auditing involves a search for facts and a systematic process of evaluating the results of operations, identifying risks, giving risk-reduction advice, assessing the adequacy of controls, implementing improvements in control procedures and ensuring an effective governance structure.

Reference: Learning objective 2.4 ~ understand the roles of internal and operational audits in the governance processes.

36. Explain the difference between external and internal auditors.

Correct answer:
External auditors are either individual practitioners or members of public accounting firms who render professional auditing services to clients. The clients of external auditors include profit-making business enterprises, not-for-profit organisations, government agencies and individuals.

Internal auditors are employees of the entities they audit and they are involved in an independent appraisal activity within an organisation, as a service to the organisation.

Reference: Learning objective 2.4 ~ understand the roles of internal and operational audits in the governance processes.

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