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Corret Answers are located at the end of each chapter.

TRUE/FALSE - Write 'T' if the statement is true and 'F' if the statement is false.

1) Auditing focuses on rules, techniques, and computations required to prepare and analyze financial information.
   - ◎ true
   - ◎ false

2) Decision makers demand reliable information that is provided by accountants and accounting information systems.
   - ◎ true
   - ◎ false

3) Information asymmetry seldom occurs.
   - ◎ true
   - ◎ false

4) Conflicts of interest often occur between absentee owners (principals) and managers (agents).
   - ◎ true
   - ◎ false

5) Auditing services and attest services are the same.
   - ◎ true
   - ◎ false

6) Auditing is a type of attest service.
   - ◎ true
   - ◎ false

7) Testing all transactions that occurred during the period is cost prohibitive in the absence of computer-based audit data analytic approaches.
   - ◎ true
   - ◎ false

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MULTIPLE CHOICE - Choose the one alternative that best completes the statement or answers the question.

8) Why do auditors generally use a sampling approach to evidence gathering?
   A) Auditors are experts and do not need to look at much to know whether the financial statements are correct or not.
   B) Auditors must balance the cost of the audit with the need for precision and for some types of evidence; computer-based audit data analytic approaches can't be used.
   C) Auditors must limit their exposure to their auditee to maintain independence.
   D) The auditor's relationship with the auditee is generally adversarial, so the auditor will not have access to all of the financial information of the company.

9) Which of the following statements best describes a relationship between sample size and other elements of auditing?
   A) If materiality increases, so will the sample size.
   B) If the desired level of assurance increases, sample sizes can be smaller.
   C) If materiality decreases, sample size will need to increase.
   D) There is no relationship between sample size and materiality or the desired level of assurance.

10) Which of the following statements about the study of auditing is **NOT** true?
   A) The study of auditing can be valuable to future accountants and business decision makers whether or not they plan to become auditors.
   B) The study of auditing focuses on learning the analytical and logical skills necessary to evaluate the relevance and reliability of information.
   C) The study of auditing focuses on learning the rules, techniques, and computations required to analyze financial statements for making investment recommendations.
   D) The study of auditing begins with the understanding of a coherent logical framework and techniques useful for gathering and analyzing evidence about others' assertions.

11) The basic definition of auditing states it is a process to ____.
   A) detect fraud
   B) examine individual transactions so that the auditor may certify as to their validity
   C) objectively obtain and evaluate evidence regarding assertions
   D) assure the consistent application of correct accounting procedures

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12) Assurance services may improve all of the following **EXCEPT** ____.

A) relevance
B) credibility
C) periodicity
D) reliability

13) Evidence is most reliable if it ____.

A) signals the true state of a management assertion
B) applies to the period being audited
C) relates to the audit assertion being tested
D) is sufficient to justify a conclusion

14) Which of the following best describes the concept of audit risk?

A) the risk of the auditor being sued because of association with an auditee
B) the risk that the auditor will provide an inappropriate opinion on financial statements that are, in fact, materially misstated
C) the overall risk that a material misstatement exists in the financial statements
D) the risk that auditors use audit procedures that are inappropriate

15) An auditor who accepts an audit engagement and does **NOT** possess expertise with respect to the business entity's industry, should ____.

A) engage financial experts familiar with the nature of the business entity
B) obtain a knowledge of matters that relate to the nature of the entity's business and the industry in which it operates
C) refer a substantial portion of the audit to another CPA, who will act as the principal auditor
D) first inform management that an unqualified opinion cannot be issued

16) During the client acceptance/continuance phase of an audit, a CPA most likely would ____.

A) identify specific internal control activities that are likely to prevent fraud
B) evaluate the reasonableness of the company's accounting estimates
C) evaluate the integrity of management
D) inquire of the company's attorney as to whether any unrecorded claims are probable or asserted

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17) In the context of agency relationship, information asymmetry refers to the idea that ____.
A) information can vary in its reliability
B) information can vary in its relevance
C) management has more information about the entity's true financial position than do the absentee owners (i.e., stockholders)
D) management likely will not act in the best interests of the absentee owners

18) Which of the following best describes why an independent auditor is asked to express an opinion on the fair presentation of financial statements?
A) It is difficult to prepare financial statements that fairly present a company's financial position and changes in cash flows without the expertise of an independent auditor.
B) It is management's responsibility to seek available independent aid in the appraisal of the financial information shown in its financial statements.
C) The opinion of an independent party is needed because a company is not likely to be considered objective with respect to its own financial statements.
D) It is a customary courtesy that all stockholders of a company receive an independent report on management's stewardship in managing the affairs of the business.

19) Which of the following best describes the fundamental, underlying reason for why there is demand for an independent auditor to report on financial statements?
A) A management fraud may exist and it is more likely to be detected by auditors if they are independent.
B) Different interests may exist between the company preparing the statements and the parties using the statements.
C) A misstatement of account balances may exist and it is the independent auditor's responsibility to ensure that financial statements are not misstated.
D) A poorly designed internal control system may be in place.

20) Which of the following best describes why publicly-traded corporations follow the practice of having the external auditor appointed by the board of directors or elected by the stockholders?
A) to promote an adversarial relationship between the auditor and the corporation's management
B) to enhance auditor independence from the management of the corporation
C) to encourage a policy of rotation of the independent auditors
D) to give management more leverage over the auditor's decisions

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21) Auditing is defined as a "systematic process of objectively obtaining and evaluating evidence regarding assertions..." What is meant by "systematic process"?

A) All audits involve obtaining the same evidence.
B) All audits involve evaluating evidence in the same manner.
C) There should be a well-planned approach for obtaining and evaluating evidence.
D) All assertions are equally important for all audits.

22) Which of the following would best be described as an assurance service?

A) preparing a report representing a client's position during an IRS audit
B) working with a company to develop a more efficient method of processing financial transactions
C) offering an opinion concerning the accuracy of statements made on an entity's website relating to its online privacy policies
D) assisting a company in identifying potential sources of capital for potential acquisitions

23) Which of the following statements is **NOT** true with respect to assurance, attest, and audit services?

A) These services are applied only to financial statements and financial statement accounts.
B) These services all involve obtaining and evaluating evidence.
C) These services all involve determining the correspondence of some information to a set of criteria.
D) These services all involve issuing a report.

24) Which of the following factors is the primarily focus in determining materiality?

A) whether the auditor will be able to issue a “clean” opinion at the end of the audit
B) the cost-benefit of detecting a misstatement
C) the suspected amount of misstatements that will be discovered
D) the users of the financial statements

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25) When obtaining an understanding of the entity and its environment, the auditor should obtain an understanding of internal controls primarily to ____.
A) identify areas of relatively high risk of misstatement and plan the audit accordingly
B) provide suggestions for improvement to the company
C) serve as a basis for setting audit risk and materiality
D) decide whether to perform an audit for the company

26) Which one of the following statements best describes the concept of materiality?
A) Materiality is determined by reference to specific quantitative guidelines established by the AICPA.
B) Materiality depends only on the dollar amount of an item relative to other items in the financial statements.
C) Materiality depends on the nature of an item but not on the dollar amount of the item.
D) Materiality is largely a matter of professional judgment and reflects both quantitative and qualitative considerations.

27) Before accepting an engagement to audit a new entity, an auditor is required to ____.
A) make inquiries of the predecessor auditor
B) tell the company whether or not the auditor is willing to issue a "clean" opinion
C) prepare a memorandum setting forth the staffing requirements and documenting the preliminary audit plan
D) become a member of the entity's board of directors

28) An investor is reading the financial statements of the Stankey Corporation and observes that the statements are accompanied by an auditor's unqualified report. From this, the investor may conclude that ____.
A) any disputes over material accounting issues have been settled to the auditor's satisfaction and that the financial statements are presented fairly
B) the auditor is satisfied that Stankey will be highly profitable in the future
C) the auditor is certain that Stankey's financial statements have been prepared accurately and that all account balances are precisely correct
D) the auditor has determined that Stankey's management is not qualified to lead the company

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29) Preliminary engagement activities include of the following **EXCEPT** ____.

A) evaluating internal controls
B) determining the audit team requirements
C) ensure that the audit firm and team members are independent
D) establish an understanding with the client regarding what services are to be performed

30) The auditor's report is generally addressed to the ____.

A) chief operating officer
B) securities and exchange commission
C) stockholders of the company
D) chief financial officer

31) Which of the following is true with respect to the auditor's report?

A) The report indicates that the company's financial statements were audited in accordance with generally accepted accounting standards.
B) The report indicates that the company's financial statements were audited in accordance with applicable auditing standards.
C) The report indicates that the company's financial statements were audited in accordance based on managements best judgement.
D) The report indicates that the company's financial statements are free from all misstatement and error.

32) Which of the following is **NOT** a concept that is included in the Basis of Opinion paragraph of the auditor's report?

A) The conformance of the financial statements with generally accepted accounting principles (e.g., IFRS).
B) The audit was conducted in accordance with generally accepted auditing standards.
C) The auditors are independent of the company.
D) The auditor has obtained sufficient and appropriate audit evidence to form their opinion.

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33) Which of the following is **NOT** a benefit of emerging audit technologies?

A) automate much of the more tedious work that auditors perform
B) the potential to dramatically enhance the effectiveness and the value of the external audit
C) leave more time for auditors to better understand the businesses they are auditing the underlying risks related to financial reporting
D) remove the challenge of junior auditor work and make that work less interesting

34) Information Risk is defined as the risk that ____.

A) information circulated by a company's management will be false or misleading
B) an assertion contains a misstatement, before considering internal controls
C) auditor has followed appropriate auditing standards and issued a standard unqualified opinion, and the financial statements contain a material misstatement
D) the internal controls will not prevent or detect a misstatement in the financial statements

35) The two key descriptors of audit evidence are ____.

A) sufficient and relatable
B) relatable and reliable
C) reliable and appropriate
D) sufficient and appropriate

SHORT ANSWER. Write the word or phrase that best completes each statement or answers the question.

36) On a high level, the accounting processes of a business consist of internal controls, individual transactions, and account balances.

Required:

A. Describe the relationship between internal controls, individual transactions, and account balances.
B. Discuss how evidence regarding each of these three areas can help an auditor determine if the financial statements are fairly stated.

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37) Sally Thompson's company, Sally's Shoes, is a successful shoe retail business with one store. Sally would like to expand to two locations, but the bank has asked for an independent audit before it will provide financing. Sally hires her brother-in-law, George Thompson, to perform the audit. George has experience in auditing non-profit organizations, and he decides to perform the audit the same way as his other audits. After completing all the steps of the audit process, George issues an unqualified opinion indicating that he is certain that the company's financial statements contain no misstatements. Comment on any potential problems with George's audit of Sally's Shoes.

38) Explain the relationship between audit, attest and assurance services.

39) Define "information asymmetry" and discuss it in the context of the financial markets. Include in your discussion how information asymmetry is reduced.

40) The textbook presented the concept of auditing through an analogy that involved buying a house and hiring a house inspector. Name three desirable qualities of a house inspector or an auditor and discuss how those qualities apply to an auditor and why those qualities are important for an auditor to possess.

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41) Discuss an overview of the financial statement audit process using the terms "assertion," "evidence," and "report."

42) Why must an auditor assess materiality as part of planning an audit engagement?

43) Name and discuss the major phases of the audit process.

44) A standard, unqualified auditor's report for a public company contains many sections. Provide a brief (one or two sentences) description for each of the following sections: Opinion on the Financial Statements, Basis for Opinion, and Key Audit Matters.

45) Explain the relationship between sample size, materiality, and desired level of assurance.

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46) The cost of capital can be generally defined as the rate of return expected by anyone who provides capital to a company (e.g., an investor or a bank). How can a financial statement audit reduce the cost of capital for a company?

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Answer Key

Test name: Chapter 01

1) FALSE
2) TRUE
3) FALSE
4) TRUE
5) FALSE
6) TRUE
7) TRUE
8) B
9) C
10) C
11) C
12) C
13) A
14) B
15) B
16) C
17) C
18) C
19) B
20) B
21) C
22) C
23) A
24) D
25) A
26) D
27) A
28) A
29) A
30) C
31) B
32) A
33) D
34) A
35) D
36) Short Answer
37) Short Answer

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38) Short Answer
39) Short Answer
40) Short Answer
41) Short Answer
42) Short Answer
43) Short Answer
44) Short Answer
45) Short Answer
46) Short Answer

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