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CORRECT ANSWERS ARE LOCATED IN THE 2ND HALF OF THIS DOC.

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

1) Control risk is
   A) the probability that a material misstatement could not be prevented or detected by the entity's internal control policies and procedures.
   B) the probability that a material misstatement could occur and not be detected by auditors' procedures.
   C) the risk that auditors will not be able to complete the audit on a timely basis.
   D) the risk that auditors will not properly control the staff on the audit engagement.

2) The responsibilities principle under generally accepted auditing standards does *not* include which of the following?
   A) Competence and capabilities.
   B) Independent attitude.
   C) Due care.
   D) Planning and supervision.

3) Which of the following types of auditors' reports does *not* require additional information to support the opinion?
   A) Unmodified opinion.
   B) Adverse opinion.
   C) Qualified opinion.
   D) Disclaimer of opinion.

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4) Which of the following is an element of a system of quality control that should be considered by a public accounting firm in establishing its quality control policies and procedures?
   A) Lending credibility to a client's financial statements.
   B) Using statistical sampling techniques.
   C) Acceptance and continuance of client relationships and specific engagements.
   D) Membership in the Center for Public Company Audit Firms.

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5) Which of the following presumptions does *not* relate to the reliability of audit evidence?
   A) The more effective the client's internal control, the more assurance it provides about the accounting data and financial statements.
   B) The auditors' opinion, to be economically useful, is formed within reasonable time and based on evidence obtained at a reasonable cost.
   C) Evidence obtained from independent sources outside the entity is more reliable than evidence secured solely within the entity.
   D) The independent auditors' direct personal knowledge, obtained through observation and inspection, is of higher quality than information obtained indirectly.

6) An important role of the Public Company Accounting Oversight Board is to oversee the
   A) issuance of statements by the Financial Accounting Standards Board.
   B) preparation and grading of the Uniform CPA Examination.
   C) peer review of member firms of the Private Companies Practice Section.
   D) regulation of firms that audit issuers.

7) Audit evidence is usually considered sufficient when
   A) it is reliable.
   B) there is enough quantity to afford a reasonable basis for an opinion on financial statements.
   C) it has the qualities of being relevant, objective, and free from unknown bias.
   D) it has been obtained through random selection methods.

8) Which of the following is *not* considered a type of audit evidence?
   A) The entity's trial balance.
   B) Auditors' calculations.
   C) Physical observation.
   D) Verbal statements made by client personnel.

9) An audit of the financial statements of Camden Corporation is being conducted by external auditors. The external auditors are expected to:
   A) certify the correctness of Camden's financial statements.
   B) make a complete examination of Camden's records and verify all of Camden's transactions.
   C) give an opinion on the fair presentation of Camden's financial statements in conformity with the applicable financial reporting framework (e.g., GAAP, IFRS).
   D) give an opinion on the attractiveness of Camden for investment purposes and critique the wisdom and legality of its business decisions.

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10) Auditors try to achieve independence in appearance in order to:
A) maintain public confidence in the profession.
B) become independent in fact.
C) comply with the responsibilities principle.
D) maintain an unbiased mental attitude.

11) The preparation of an audit plan prior to the beginning of field work is appropriately considered documentation of
A) planning.
B) supervision.
C) information evaluation.
D) quality assurance.

12) Which of the following procedures would provide the most reliable audit evidence?
A) Inquiries of the client's accounting staff held in private.
B) Inspection of pre-numbered client shipping documents.
C) Inspection of bank statements obtained directly from the client's financial institution.
D) Analytical procedures performed by auditors on the client's trial balance.

13) Which of the following would most likely be a violation of the independence requirement found in the responsibilities principle under generally accepted auditing standards?
A) An auditor on the engagement has a distant relative who is employed by a vendor that does a significant amount of business with clients.
B) The client's Chief Executive Officer graduated from the same university as the partner in charge of the accounting firm.
C) An auditor on the engagement owns a financial interest in the stock of the client.
D) The client provides financial support to a number of charitable causes that also receive support from the accounting firm.

14) A vendor's invoice received and held by the client would be considered what type of evidence?
A) External.
B) Internal.
C) External–internal.
D) Written representation.

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15) Which of the following statements is generally correct about the appropriateness of audit evidence?
   A) Auditors' direct personal knowledge, obtained through observation and inspection, is of higher quality than information obtained indirectly from independent outside sources.
   B) To be reliable, audit evidence must be either valid or relevant, but need not be both.
   C) Client accounting data alone may be considered sufficient appropriate audit evidence to issue an unmodified opinion on client financial statements.
   D) Appropriateness of audit evidence refers to the amount of corroborative evidence to be obtained.

16) The standard auditors' report refers to standards of the PCAOB and GAAP in which section(s)?
   A) Standards of the PCAOB: Basis for Opinion; GAAP: Opinion on the Financial Statements.
   B) Standards of the PCAOB: Opinion on the Financial Statements; GAAP: Opinion on the Financial Statements and Basis for Opinion.
   C) Standards of the PCAOB: Opinion on the Financial Statements and Basis for Opinion; GAAP: Opinion on the Financial Statements.
   D) Standards of the PCAOB: Opinion on the Financial Statements; GAAP: Opinion on the Financial Statements.

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17) Which of the following is *not* included in the auditors' standard report representing an unmodified opinion?
   A) A brief indication of the responsibility of auditors and management for the financial statements.
   B) An indication that all appropriate disclosures have been made and included in the financial statements.
   C) An indication that the audit was conducted in accordance with standards established by the PCAOB.
   D) The auditors' opinion on the fairness of the financial statements.

18) Internal evidence
   A) is obtained directly from third parties independent of the client.
   B) originates outside of the client's system but has been received and processed by the client.
   C) consists of documents that are produced, used, and stored within the client's information system.
   D) consists of representations made by the client's officers, directors, owners, and employees.

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19) Which of the following presumptions is correct about the reliability of audit evidence?
A) Information obtained indirectly from outside sources is the most reliable form of audit evidence.
B) To be reliable, audit evidence should be convincing rather than persuasive.
C) Reliability of audit evidence refers to the amount of corroborative evidence obtained.
D) An effective system of internal control provides more assurance about the reliability of audit evidence.

20) The auditors' responsibility to express an opinion on the financial statements is
A) implicitly represented in the auditors' standard report.
B) explicitly represented in the Opinion on the Financial Statements section of the auditors' standard report.
C) explicitly represented in the Basis for Opinion section of the auditors' standard report.
D) explicitly represented in the Critical Audit Matters section of the auditors' standard report.

21) Which of the following is *not* a concept from the performance principle under generally accepted auditing standards?
A) The auditor must plan the work and properly supervise any assistants.
B) The auditor must express an opinion in accordance with the auditor's findings.
C) The auditor must obtain sufficient appropriate evidence about whether material misstatements exist.
D) The auditor must determine and apply an appropriate materiality level throughout the audit.

22) Under generally accepted auditing standards, which of the following relates to the responsibilities principle?
A) The initial planning of the audit engagement.
B) The confirmation of accounts receivable.
C) The completion of an internal control questionnaire.
D) Maintaining professional skepticism and exercising professional judgment.

23) Which of the following represent audit quality guides that remain stable over time and are applicable for all audits?
A) Auditing procedures.
B) Auditing standards.
C) Due care.
D) System of quality control.

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24) Which of the following situations would most likely be in conflict with the responsibilities principle?
A) Auditors perform the engagement with the performance level expected of prudent auditors, but not expert auditors.
B) Auditors obtain expertise in their client's industry as they are conducting the audit examination.
C) Auditors are directly involved with a client manager in a strategic decision-making capacity.
D) Auditors fail to document their assessment of control risk following their study of internal control.

25) Which of the following statements is *not* true with respect to the evidence that would be gathered when assessments of control risk are high?
A) Auditors would be required to rely on external (rather than internal) forms of evidence.
B) Auditors would be required to perform procedures at interim periods, rather than at year end.
C) Auditors would be required to confirm a larger number of customer accounts receivable balances.
D) Auditors would be required to obtain more evidence through direct personal observation.

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26) As it relates to audit evidence, appropriateness refers to the
A) originality of evidence gathered.
B) quality of evidence gathered.
C) quantity of evidence gathered.
D) timeliness of evidence gathered.

27) Which of the following information would *not* be included in the auditors' standard report?
A) The names of the financial statements audited.
B) A description of the nature of an audit.
C) An indication that all necessary disclosures have been presented.
D) An opinion on the entity's financial statements.

28) The primary purpose of the auditors' study of internal control for a nonissuer is:
A) to provide constructive suggestions to the client for improving its internal control.
B) to report on internal control as required by *Auditing Standard No. 5.*
C) to identify and detect fraud and irregularities perpetrated by client personnel.
D) to determine the nature, timing, and extent of further audit procedures.

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29) Which reporting options do auditors have if the client's financial statements are not presented according to the applicable financial framework (e.g., GAAP, IFRS)?
A) Unmodified opinion or disclaimer of opinion.
B) Qualified opinion or disclaimer of opinion.
C) Unmodified opinion or adverse opinion.
D) Qualified opinion or adverse opinion.

30) Which of the following statements is true with respect to the quality of audit evidence?
A) Quality is related to the relevance of evidence, but not the reliability of evidence.
B) Evidence is considered of higher quality when gathered prior to year-end than following year-end.
C) Evidence obtained under environments of stronger internal control is of higher quality than evidence obtained under environments of weaker internal control.
D) In evaluating quality, sufficiency of evidence is of greater importance than appropriateness of evidence.

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31) Which of the following concepts is least related to the risk of material misstatement?
A) Control risk.
B) Detection risk.
C) Inherent risk.
D) Materiality.

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32) Which of the following statements describes an appropriate relationship with respect to the reliability of audit evidence?
A) Receiving confirmation from third parties as to the existence of securities is more reliable than the auditors' personal inspection of those securities.
B) Verbal inquiries received from the client regarding sales made to customers are more reliable than sales invoices prepared by the client for its customers.
C) A bank confirmation received directly by the auditor is more reliable than a bank confirmation initially received by the client and forwarded to the auditor.
D) Evidence drawn from a document prepared by the client is more reliable than evidence drawn from a document prepared by an external party that is forwarded to the auditor by the client.

33) A periodic review of an audit firm's system of quality control by the PCAOB is referred to as a(n):
A) inspection.
B) peer review.
C) principles review.
D) quality review.

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34) The performance principle would include all of the following except:
A) the auditors' determination of materiality levels.
B) the auditors' evaluation of independence with respect to their clients.
C) the auditors' evaluation of the risk of material misstatement.
D) the auditors' determination of the nature, timing, and extent of further audit procedures.

35) Which of the following is most closely associated with the responsibilities principle?
A) Due care.
B) Planning.
C) Qualified audit opinion.
D) Risk of material misstatement.

36) Which of the following statements is *not* true with respect to the responsibility for establishing auditing standards?
A) The PCAOB issues auditing standards for the audit of issuers, subject to SEC approval.
B) Standards issued by the Auditing Standards Board after 2003 apply to the audits of both issuers and nonissuers.
C) The Auditing Standards Board currently issues auditing standards for the audit of nonissuers.
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D) Prior to the Sarbanes–Oxley Act, the Auditing Standards Board issued auditing standards for the audits of both issuers and nonissuers.

37) Which of the following would normally be considered earliest in the audit examination?
A) Determination of materiality levels for use during the audit.
B) Consideration of the ability of the entity's internal control to prevent or detect errors.
C) Preparation of a written audit plan.
D) Evaluation of the type of audit opinion to be issued, based on the auditor's findings.

38) The state of mind that characterizes the auditors' appropriate questioning and critical assessment of audit evidence is referred to as:
A) due care.
B) independence in appearance.
C) professional judgment.
D) professional skepticism.

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39) Which of the following is least related to the concept of independence in appearance?
A) The auditors' objectivity and ability to act impartially toward the client.
B) The perceptions of individuals who rely on the financial statements and auditors' opinion on the financial statements.
C) The ownership of a financial interest in a client by the auditor.
D) The employment of the auditor's family member in an important position with the client.

40) The concept of_____ recognizes that a GAAS audit may fail to detect all material misstatements.
A) absolute assurance
B) due care
C) reasonable assurance
D) risk of material misstatement

41) Generally accepted auditing standards are
A) specific actions performed by auditors during an examination.
B) standards that guide the conduct of an audit examination.
C) legal requirements auditors must observe during the audits of issuers.
D) standards used by entities in deciding whether to engage or retain the services of auditors.

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42) Which of the following could serve as a source of professional guidance in the audit of an issuer?

	Auditing Standards Issued by the PCAOB	Statements on Auditing Issued by the ASB
A.	Yes	No
B.	Yes	Yes
C.	No	Yes
D.	No	No

A) Option A
B) Option B
C) Option C
D) Option D

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43) Which of the following is *not* true with respect to the responsibilities for establishing auditing standards?
A) Auditing standards for both issuers and non-issuers must be formally approved by the Securities and Exchange Commission.
B) Interpretive publications are issued by the AICPA to provide guidance on the application of auditing standards in specific circumstances.
C) The PCAOB is the body with formal authority for the creation of auditing standards for the audits of issuers.
D) If specific guidance is not provided by PCAOB *Auditing Standards*, auditors may refer to *Statements on Auditing Standards* that have not been amended or superseded.

44) Which of the following is *not* related to the responsibilities principle?
A) Continuing professional education to ensure that professionals' knowledge keeps pace with changes in the accounting and auditing profession.
B) Firm-wide policies to evaluate the financial and professional relationships of its professionals.
C) Specific auditing procedures designed to determine the effectiveness of the entity's internal control over financial reporting.
D) The auditors' use of professional judgment throughout the examination.

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45) A level of performance that would be exercised by reasonable auditors in similar circumstances is referred to as
A) due care.
B) independence.
C) professional judgment.
D) professional skepticism.

46) During which stages of an audit examination are auditors required to exhibit the appropriate use of professional judgment?

	Gathering Evidence	Drawing Conclusions
A.	Yes	No
B.	Yes	Yes
C.	No	Yes
D.	No	No

A) Option A
B) Option B
C) Option C
D) Option D

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47) Which of the following is *not* true with respect to the concept of reasonable assurance?

A) Reasonable assurance allows for mistakes and misinterpretations by the audit team throughout the examination.
B) The nature of many audit procedures is such that they cannot always be relied upon to detect misstatements.
C) Audit teams should evaluate all transactions and components of an account balance or class of transactions.
D) Auditors should control the overall risk in an audit to an acceptably low level.

48) Which of the following factors influences the risk of material misstatement?

	Susceptibility of the Account Balance to Misstatement	Nature, Timing, and Extent of Further Audit Procedures
A.	Yes	No
B.	Yes	Yes
C.	No	Yes
D.	No	No

A) Option A
B) Option B
C) Option C
D) Option D

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49) Which of the following is *not* true with respect to the auditors' report for an issuer?

A) The report title should contain the word "independent."
B) The report provides a detailed listing of major auditing procedures performed during the examination.
C) The opinion assesses the financial statements against an applicable financial reporting framework.
D) The report specifically identifies the financial statements and years examined by the auditor.

50) Which of the following section(s) references the requirement of auditors to be independent?

A) Opinion on the Financial Statements section.
B) Basis for Opinion section.
C) Critical Audit Matters section.
D) Opinion on the Financial Statements section and Basis for Opinion section.

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51) Which of the following is true with respect to the PCAOB inspection process?
A) All firms performing audits of issuers are inspected every year.
B) PCAOB inspections are conducted by partners of other CPA firms.
C) PCAOB inspection teams review a sample of audit engagements conducted by the firm as well as the firm's system of quality control.
D) Deficiencies from sample audit engagements reviewed by the inspection team and deficiencies in the firm's system of quality control are publicly disclosed on the PCAOB's website.

52) Which of the following would be evaluated during the PCAOB inspection process?

	Firm's system of quality control	Financial viability of the firm
A.	Yes	No
B.	Yes	Yes
C.	No	Yes
D.	No	No

A) Option A
B) Option B
C) Option C
D) Option D

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53) The Public Company Accounting Oversight Board was established by which of the following?
A) The Financial Accounting Standards Board.
B) The American Institute of Certified Public Accountants.
C) The Sarbanes–Oxley Act of 2002.
D) The International Accounting Standards Board.

54) Which of the following types of audit evidence provides the *least* assurance of reliability?
A) Receivable confirmations received from the client's customers.
B) Prenumbered receiving reports completed by the client's employees.
C) Prior months' bank statements obtained from the client.
D) Municipal property tax bills prepared in the client's name.

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55) A CPA firm would provide itself reasonable assurance of meeting its responsibility to offer professional services that conform with professional standards by
A) establishing an understanding with each client concerning individual responsibilities in a signed engagement letter.
B) assessing the risk that errors and fraud may cause the financial statements to contain material misstatements.
C) developing specific audit objectives to support management's assertions that are embodied in the financial statements.
D) maintaining a comprehensive system of quality control that is suitably designed in relation to its organizational structure.

56) Which of the following courses of action is most appropriate if an auditor concludes that there is a high risk of material misstatement?
A) Use smaller, rather than larger, sample sizes.
B) Perform substantive tests as of an interim date.
C) Select more effective substantive tests.
D) Increase tests of controls.

57) Which of the following actions should a CPA firm take to comply with the AICPA's quality control standards?
A) Establish procedures that comply with the standards of the Sarbanes–Oxley Act.
B) Use attributes sampling techniques in testing internal controls.
C) Consider inherent risk and control risk before determining detection risk.
D) Establish policies to ensure that the audit work meets applicable professional standards.

58) Which of the following is a definition of control risk?
A) The risk that a material misstatement will not be prevented or detected on a timely basis by the client's internal controls
B) The risk that the auditor will not detect a material misstatement
C) The risk that the auditor's assessment of internal controls will be at less than the maximum level
D) The susceptibility of material misstatement assuming there are no related internal control policies or procedures

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59) Prior to, or in conjunction with, the information-gathering procedures for an audit, audit team members should discuss the potential for material misstatement due to fraud. Which of the following best characterizes the mind-set that the audit team should maintain during this discussion?
A) Presumptive
B) Judgmental
C) Criticizing
D) Questioning

60) An independent auditor must have which of the following?
A) A preexisting and well-informed point of view with respect to the audit
B) Technical training that is adequate to meet the requirements of a professional
C) A background in many different disciplines
D) Experience in taxation that is sufficient to comply with generally accepted auditing standards

61) What type of evidence would provide the highest level of assurance in an attestation engagement?
A) Evidence secured solely from within the entity.
B) Evidence obtained from independent sources.
C) Evidence obtained indirectly.TBEXAM.COM
D) Evidence obtained from multiple internal inquiries.

62) Which of the following is an important consideration during the planning of the audit?
A) Considering the independence of members of the audit team
B) Performing some of the audit procedures prior to the end of the year under audit
C) Considering the ability and expertise of the audit team with respect to accounting and auditing issues in the client's industry
D) Considering the impact of tests of controls on the overall assessment of control risk

63) The initial development of auditing standards was in response to
A) a scandal involving embezzlement that was not detected during an audit engagement.
B) auditors' concerns that all components of the financial statements were not being verified.
C) independent inquiries of the public accounting profession made by the SEC.
D) requests by companies for greater assurance with respect to the auditors' ability to detect financial statement misstatements.

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64) All of the following statements are true regarding auditing standards *except*:
A) departures from auditing standards that impose presumptively mandatory requirements on auditors are not permitted under any circumstances.
B) *Auditing Standards* issued by the PCAOB serve as an appropriate source of standards for the audits of issuers.
C) separate auditing standards have been developed for the audits of U.S. governmental entities and foreign entities.
D) *Interpretive Publications,* which are officially considered less authoritative and less binding than auditing standards, are included as part of auditing standards.

65) The particular and specialized actions that auditors undertake to obtain evidence in a specific audit engagement are known as
A) *Auditing Standards.*
B) audit procedures.
C) *Interpretive Publications.*
D) *Statements on Auditing Standards.*

66) The role of the Public Company Accounting Oversight Board in the standard-setting process is to develop
A) *Statements on Auditing Standards* for the audits of nonissuers.
B) *Auditing Standards* for the audits of issuers.
C) *Governmental Auditing Standards* for the audits of governmental entities.
D) *International Standards on Auditing* for the audits of foreign entities.

67) Pronouncements issued by the Public Company Accounting Oversight Board are subject to formal approval by the
A) American Institute of Certified Public Accountants.
B) Auditing Standards Board.
C) International Auditing and Assurance Standards Board.
D) Securities and Exchange Commission.

68) The three fundamental principles underlying GAAS include all of the following, *except*:
A) general principle.
B) performance principle.
C) reporting principle.
D) responsibilities principle.

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69) The fundamental principles developed by the Auditing Standards Board are best described as:
A) ten basic standards underlying an audit.
B) standards that apply only to audits of issuers.
C) industry-specific guidance on how audit procedures should be conducted.
D) guidelines for the general conduct of audit engagements.

70) The relevant ethical requirements relating to due care, professional skepticism, and professional judgment are responsibilities of the auditor at which stage(s) of the audit?

	Risk Assessment	Audit Evidence
A.	Yes	No
B.	Yes	Yes
C.	No	Yes
D.	No	No

A) Option A
B) Option B
C) Option C
D) Option D

71) Which of the following does *not* directly relate to an auditor's responsibility for having appropriate competence and capabilities to perform the audit?
A) Participating in continuing professional education
B) Gaining experience through hands-on practice
C) Obtaining reliable documentary evidence
D) Attending on-the-job training

72) Which of the following situations would result in the issuance of a disclaimer of opinion?
A) The audit reveals weaknesses in the client's internal control over financial reporting.
B) The auditor is discovered to own a financial interest in the entity.
C) The audit is performed, with limited exception, in accordance with generally accepted auditing standards.
D) The entity's financial statements are not presented in conformity with the applicable financial reporting framework.

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73) In a system of quality control, leadership responsibilities for quality within the firm are best characterized by:
A) basing personnel performance evaluations on the employees' ability to generate revenues from existing clients or by acquiring new clients.
B) management's evaluation of the integrity and business reputation of the client.
C) management's clear and consistent demonstration of its own commitment to quality control and high-quality work.
D) assigning management responsibilities in such a manner that commercial considerations are the firm's top priority.

74) The audit failures of both Enron and WorldCom were examples in which the leadership responsibilities for quality work within the accounting firm were overshadowed by fears that losing a key client would
A) result in shareholder losses from reduced company profitability.
B) require additional audit procedures and increase the fees paid by the companies to the accounting firm.
C) negatively influence the results of the firm's inspection.
D) negatively impact individual auditors' performance evaluations.

75) Which of the following is an example of the appropriate implementation of a system of quality control?
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A) The firm requires all documents obtained during the audit to be destroyed immediately following the engagement to ensure the client's information remains confidential.
B) The firm's quality control policies have evolved through the performance of audit procedures but are not formally developed or communicated to staff members.
C) All firm employees must verbally confirm their compliance with the appropriate independence requirements before being assigned to an engagement.
D) The firm uses manuals and standardized forms for audit documentation to help ensure engagement performance objectives and quality standards are met.

76) An internal evaluation of the significant judgments made by the audit team and the conclusions reached in formulating its report for engagements meeting specified criteria is known as a(n):
A) engagement quality control review.
B) inspection.
C) peer review.
D) performance control evaluation.

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77) Which element of a system of quality control strives to provide the firm with reasonable assurance that its policies and procedures are operating effectively?
A) Human resources
B) Leadership responsibilities for quality within the firm
C) Monitoring
D) Relevant ethical requirements

78) When a firm decides to withdraw from an engagement, it should document all of the following except:
A) significant issues influencing the decision to withdraw from the engagement.
B) the basis for any conclusions related to this decision to withdraw from the engagement.
C) significant consultations related to the decision to withdraw from the engagement.
D) significant effects the decision to withdraw from the engagement could have on the firm.

79) Firm A performs audits of 60 issuers, while firm B performs audits of 120 issuers. How often must each firm undergo a PCAOB inspection?
A) Both firm A and firm B will be inspected every other year.
B) Firm A will be inspected annually and firm B will be inspected every three years.
C) Firm A will be inspected every three years and firm B will be inspected annually.
D) Both firm A and firm B will be inspected annually.

80) PCAOB inspections are conducted by
A) individuals selected by the PCAOB who are not current employees of public accounting firms.
B) another public accounting firm selected by the firm being inspected.
C) current employees of another public accounting firm selected by the PCAOB.
D) the AICPA's Public Oversight Board.

81) All of the following are examples of procedures a firm can use to monitor its system of quality control *except*:
A) discussions with firm personnel.
B) conducting reviews of engagement documentation.
C) devoting sufficient resources to developing a system of quality control.
D) assessing compliance with independence policies and procedures.

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ESSAY. Write your answer in the space provided or on a separate sheet of paper.

82) Alan Fallon was recently promoted to senior accountant. He was put in charge of the Mellow Markets audit because of his experience with other grocery clients. Mellow Markets has a small, but growing, chain of natural food stores. This is the first year Mellow Markets has been audited. Because of their growth, Mellow Markets needs additional capital and intend to use their audited financial statements to secure a loan.

Alan has been assigned two inexperienced staff assistants for the audit. Because this is his first engagement as a senior, he intends to bring the job in on budget. To save time, he provided his assistants with a copy of the audit plan for Happy Time Food Stores. He told them that this would make things go more quickly. He also told them that he could not spend much time with them at the client's place of business, because "my time is billed out at such a high rate, we'll go right over budget." However, he did call them once a day from another audit on which he was working.

After beginning their work, the assistants told Alan that the audit plan did not always match up with what they found at Mellow Markets. Alan responded, "just cross out whatever is not relevant in the audit plan and don't add anything – it will only make us go over the budget."

When Alan came to the client near the end of field work, one assistant was concerned that no inventory observation was done at the out-of-town locations of Mellow Markets (the audit plan had stipulated that inventory should be observed for in-town stores only). Happy Time had only one out-of-town location, while three of Mellow Markets' five stores were in other cities. Alan told the assistant to get inventory sheets from the client for the other stores and added "make sure that the inventory balance in the general ledger agrees with the total for all the inventory sheets." The next day, Alan reviewed all audit documentation and submitted the job for review by the manager.

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Required:

1. Describe the performance principle of GAAS.
2. Do you believe that the Mellow Markets audit complies with the performance principle? Explain.

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83) For each of the items below, indicate through the appropriate letter the fundamental principle to which the item is most closely related.

A. Responsibilities principle
B. Performance principle
C. Reporting principle

___ 1. Maintaining professional skepticism.
___ 2. An auditors' overall conclusion of the fairness of the client's financial statements.
___ 3. The use of an audit plan to identify audit procedures to be performed during the engagement.
___ 4. Auditors' assessment of the risk of material misstatement.
___ 5. Accounting firm policies with respect to the level of expected continuing professional education.
___ 6. Expressing an opinion in accordance with the auditor's findings.
___ 7. Proper supervision of assistants on the audit.
___ 8. Auditors' requests to obtain bank statements directly from financial institutions with whom the client does business.
___ 9. An indication that an opinion cannot be expressed.
___ 10. Determining and applying an appropriate materiality level.

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84) For each of the statements below, indicate through the appropriate letter whether it relates to the PCAOB, Auditing Standards Board, both the PCAOB and Auditing Standards Board, or neither the PCAOB nor Auditing Standards Board.

A. PCAOB
B. Auditing Standards Board
C. Both PCAOB and Auditing Standards Board
D. Neither PCAOB nor Auditing Standards Board

___ 1. Conducts inspections of firms that audit issuers.
___ 2. Pronouncements may be used in the audit of non-issuers.
___ 3. Pronouncements may be used in the audit of issuers.
___ 4. Was created by the Sarbanes Oxley Act of 2002.
___ 5. Involved with the certification and licensure of public accountants.
___ 6. Issues *Statements on Auditing Standards*.
___ 7. Conducts peer reviews of firms that audit non-issuers.
___ 8. Sanctions individual auditors for violations of generally accepted auditing standards.

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85) For each of the items below, indicate through the appropriate letter the element of a system of quality control to which it is most closely related.

A. Leadership responsibilities
B. Relevant ethical requirements
C. Acceptance and continuance of clients
D. Human resources
E. Engagement performance
F. Monitoring

___ 1. Reviewing selected administrative and personnel records.
___ 2. Obtaining written confirmations regarding compliance with appropriate independence requirements.
___ 3. Ensuring that financial considerations do not override the quality of work performed.
___ 4. Establishing policies and procedures for resolving differences of opinion within the engagement team.
___ 5. Devoting sufficient resources for developing, communicating, and supporting the firm's quality control policies and procedures.
___ 6. Evaluating the integrity and business reputation of the client.
___ 7. Identifying circumstances and relationships that create threats to auditor independence.
___ 8. Ensuring the firm's ability to perform the engagement with an appropriate level of professional competence.
___ 9. Maintaining engagement documentation for an appropriate period of time.
___ 10. Assessing the appropriateness of the firm's guidance materials and professional aids.

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Answer Key

Test name: Chapter 02

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

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38) D
39) A
40) C
41) B
42) B
43) A
44) C
45) A
46) B
47) C
48) A
49) B
50) B
51) C
52) A
53) C
54) B
55) D
56) C
57) D
58) A
59) D
60) B
61) B
62) B
63) A
64) A
65) B
66) B
67) D
68) A
69) D
70) B
71) C
72) B
73) C
74) D
75) D
76) A
77) C

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78) D
79) C
80) A
81) C
82) Essay
According to the performance principle, to obtain reasonable assurance, which is high but not an absolute level of assurance, the auditor:

1. Plans the work and properly supervises any assistants.
2. Determines and applies appropriate materiality level or levels throughout the audit.
3. Identifies and assesses risks of material misstatement, whether due to fraud or error, based on an understanding of the entity and its environment, including the entity's internal control.
4. Obtains sufficient appropriate audit evidence about whether material misstatements exist, through designing and implementing appropriate responses to the assessed risks.

The Mellow Markets audit does not comply with the performance principle. With respect to planning, the failure to prepare an appropriate audit plan and lack of time and attention the inexperienced staff received from Alan violate the performance principle. In addition, there is no indication that any steps were taken to either understand the client's business or its internal control. Finally, these deficiencies suggest that the appropriate procedures were not performed to collect sufficient appropriate evidence. Further, the lack of a relevant plan to observe inventory in other cities and Alan's decision to limit inventory procedures to agreeing the inventory sheets and the general ledger inventory balance demonstrates the failure to gather sufficient appropriate evidence and represents an overall violation of the performance principle.

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83) Essay
1. A; 2. C; 3. B; 4. B; 5. A; 6. C; 7. B; 8. B; 9. C; 10. B.

84) Essay
1. A; 2. B; 3. C; 4. A; 5. D; 6. B; 7. D; 8. D.

85) Essay
1. F; 2. B; 3. A; 4. E; 5. A; 6. C; 7. B; 8. C; 9. E; 10. F.

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