Auditing A Risk Based-Approach to Conducting a Quality Audit 10th edition Johnstone Test Bank

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Chapter 2 - The Auditor's Responsibilities Regarding Fraud and Mechanisms to Address Fraud: Regulation and Corporate Governance

1. The auditor is not responsible for the presentation of financial statements; therefore, the auditor has no responsibility for fraud in the financial statements.

a. True
b. False

ANSWER: False
POINTS: 1
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Auditor's Responsibility to Detect Fraud

2. An example of fraudulent financial reporting is the CFO intentionally overstating sales to boost profits.

a. True
b. False

ANSWER: True
POINTS: 1
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Types of Frauds

3. 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
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: User Expectations of Auditor Responsibility

4. Auditors need to consider fraud arising from misappropriation of assets and fraudulent financial reporting.

a. True
b. False

ANSWER: True
POINTS: 1
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Types of Frauds

5. Fraud is an intentional act involving the use of deception that results in a material misstatement of the financial statements.

a. True

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b. False

ANSWER: True
POINTS: 1
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Types of Frauds

6. 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

ANSWER: False
POINTS: 1
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Types of Frauds

7. 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
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Types of Frauds

8. Consideration of fraud in financial statement audits is a relatively new concept derived originally from the Sarbanes-Oxley Act.

a. True
b. False

ANSWER: False
POINTS: 1
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: User Expectations of Auditor Responsibility

9. 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

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ANSWER: False
POINTS: 1
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Types of Frauds

10. The onslaught of fraud in financial statements over the recent decade has been the first of its kind in history.
    a. True
    b. False

ANSWER: False
POINTS: 1
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: User Expectations of Auditor Responsibility

11. The fraud triangle requires the auditor to actively consider and assess the risk of fraud for clients and their financial statements.
    a. True
    b. False

ANSWER: False
POINTS: 1
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: User Expectations of Auditor Responsibility

12. 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
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Auditor's Responsibility to Detect Fraud

13. If an auditor discovers evidence of fraud, the planned audit procedures should be adjusted accordingly.
    a. True
    b. False

ANSWER: True
POINTS: 1
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking

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TOPICS: Auditor's Responsibility to Detect Fraud

14. 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
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Auditor's Responsibility to Detect Fraud

15. According to professional audit standards, the audit team should assemble early in the planning stages of an audit to conduct a fraud "brainstorming" meeting in order to determine the types of fraud that may occur with the client.

a. True
b. False

ANSWER: True
POINTS: 1
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Fraud Risk Assessment and Detection Procedures

16. Rationalization is one element of the Fraud Triangle.

a. True
b. False

ANSWER: True
POINTS: 1
LEARNING OBJECTIVES: AUDT.JOHN.16.02-01 - LO: 02-01
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Fraud Defined

17. Once the fraud assessment is complete in the planning stage, the auditor need not consider fraud further.

a. True
b. False

ANSWER: False
POINTS: 1
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Fraud Risk Assessment and Detection Procedures

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18. Pressure upon management to manipulate financial information is a common characteristic in fraud cases.
    a. True
    b. False

ANSWER: True
POINTS: 1
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Auditor's Responsibility to Detect Fraud

19. Management compensation that is tied to profits may create incentives to commit fraud.
    a. True
    b. False

ANSWER: True
POINTS: 1
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Identify Fraud Risk Indicators

20. Management may feel pressure to maintain debt covenants, which is a deterrent to fraud.
    a. True
    b. False

ANSWER: False
POINTS: 1
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Identify Fraud Risk Indicators

21. Audit procedures to detect fraud are generally an expansion of normal audit procedures.
    a. True
    b. False

ANSWER: False
POINTS: 1
LEARNING OBJECTIVES: AUDT.JOHN.16.02-03 - LO: 02-03
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Recent History of Fraudulent Financial Reporting

22. Complex transactions such as derivative instruments provide management certain opportunities to manipulate financial statements to its advantage.
    a. True
    b. False

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ANSWER: True
POINTS: 1
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Identify Fraud Risk Indicators

23. A board of directors that is actively involved in monitoring management mitigates opportunities to commit fraud.
a. True
b. False
ANSWER: True
POINTS: 1
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Identify Fraud Risk Indicators

24. Rationalization involves the mindset of the fraudster to justify committing the fraud.
a. True
b. False
ANSWER: True
POINTS: 1
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Identify Fraud Risk Indicators

25. The auditor should not consider that fraud is present in revenue accounts because revenue is not typically a very complex account.
a. True
b. False
ANSWER: False
POINTS: 1
LEARNING OBJECTIVES: AUDT.JOHN.16.02-03 - LO: 02-03
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Recent History of Fraudulent Financial Reporting

26. Management always uses journal entries to commit fraud because they are not reviewed by auditors.
a. True
b. False
ANSWER: False
POINTS: 1

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NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Identify Fraud Risk Indicators

27. Auditors must keep a questioning mind when analyzing management responses to inquiry and auditors should strive to obtain corroborating evidence before accepting the management responses.

a. True
b. False

ANSWER: True
POINTS: 1
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Identify Fraud Risk Indicators

28. The auditor must perform a brainstorming session with client management in order to plan the procedures to be performed.

a. True
b. False

ANSWER: False
POINTS: 1
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Identify Fraud Risk Indicators

29. 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
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Identify Fraud Risk Indicators

30. One fraud risk factor includes the presence of domineering members of management who seek the ultimate loyalty of subordinates.

a. True
b. False

ANSWER: True
POINTS: 1
NATIONAL STANDARDS: United States - BUSPORG: Analytic

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STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Identify Fraud Risk Indicators

31. 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
ANSWER: True
POINTS: 1
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Linking Fraud Risk to Audit Procedures

32. Audit tests do not relate to fraud testing because testing for fraud is conducted in a separate engagement.
    a. True
    b. False
ANSWER: False
POINTS: 1
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Linking Fraud Risk to Audit Procedures

33. 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
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Linking Fraud Risk to Audit Procedures

34. Various types of ways that fraud could be perpetrated should be hypothesized by the auditor prior to conducting audit testing.
    a. True
    b. False
ANSWER: True
POINTS: 1
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Linking Fraud Risk to Audit Procedures

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35. When fraud risk is great in the organization under audit, procedures applied are likely to be more extensive.
    a. True
    b. False

ANSWER: True
POINTS: 1
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Linking Fraud Risk to Audit Procedures

36. The Sarbanes-Oxley Act significantly enhanced criminal penalties for crimes involving the destruction or alteration of corporate audit records.
    a. True
    b. False

ANSWER: True
POINTS: 1
LEARNING OBJECTIVES: AUDT.JOHN.16.02-05 - LO: 02-05
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: The Sarbanes-Oxley Act of 2002

37. During the time period of 1998 to 2007, the median size of public company perpetrating fraud rose tenfold to $100 million (as compared to the previous ten years).
    a. True
    b. False

ANSWER: True
POINTS: 1
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Types of Frauds

38. According to COSO studies, the majority of the frauds took place at companies that were listed on the Over-The-Counter (OTC) market, rather than those listed on the NYSE or NASDAQ.
    a. True
    b. False

ANSWER: True
POINTS: 1
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Types of Frauds

39. Auditors are responsible to fraud even if it has an immaterial effect on the financial statements.

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a. True
b. False

ANSWER: False
POINTS: 1
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Major Frauds and Audit Procedures

40. The landmark Enron fraud in the early 2000's involved the movement of significant debt off the books to related, unconsolidated entities.

a. True
b. False

ANSWER: True
POINTS: 1
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Major Frauds and Audit Procedures

41. Successful 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

ANSWER: True
POINTS: 1
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Fraud Risk Indicators

42. Transparency is a desirable, but not critical, element of effective corporate governance.

a. True
b. False

ANSWER: False
POINTS: 1
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Identify Fraud Risk Indicators

43. The auditor has a responsibility to design the audit to provide absolute assurance of detecting material fraud.

a. True
b. False

ANSWER: False

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POINTS: 1
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Auditor's Responsibility to Detect Fraud

44. According to the Sarbanes-Oxley Act, the audit committee must have at least 3 independent members..
a. True
b. False
ANSWER: False
POINTS: 1
LEARNING OBJECTIVES: AUDT.JOHN.16.02-05 - LO: 02-05
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: The Sarbanes-Oxley Act of 2002

45. 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
POINTS: 1
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Linking Audit Procedures and to Fraud Risk

46. 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
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Professional Skepticism

47. The objective of financial reporting is to provide useful information to interested users.
a. True
b. False
ANSWER: True
POINTS: 1
NATIONAL STANDARDS: United States - BUSPORG: Analytic

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STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Corporate Governance and Auditing

48. Corporate governance is a process by which the owners, but not the creditors, exert control and require accountability for the resources entrusted to the organization.

a. True
b. False

ANSWER: False
POINTS: 1
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Corporate Governance and Auditing

49. The audit committee is a subcommittee of the board of directors comprised of independent outside directors.

a. True
b. False

ANSWER: True
POINTS: 1
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Enhanced Role of Audit Committees

50. Implementing an effective ethical environment is primarily the responsibility of the audit committee of the Board of Directors.

a. True
b. False

ANSWER: True
POINTS: 1
LEARNING OBJECTIVES: AUDT.JOHN.16.02-06 - LO: 02-06
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Required Audit Firm Communication to the Audit Committee
Corporate Governance Responsibilities

51. Any major disagreement the auditor has with management should be discussed with the audit committee.

a. True
b. False

ANSWER: True
POINTS: 1
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking

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TOPICS: Required Audit Firm Communication to the Audit Committee

52. Managers of organizations are hired by Boards of Directors to perform responsibilities such as the implementation of internal control.

a. True
b. False

ANSWER: True
POINTS: 1
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Corporate Responsibility for Financial Reporting

53. 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
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Generally Accepted Auditing Standards and IAASB Principles

54. 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
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Enhanced Role of Audit Committees

55. Management of companies should have the ability to hire and fire the external auditor.

a. True
b. False

ANSWER: False
POINTS: 1
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Enhanced Role of Audit Committees

56. The audit committee should have the authority to hire and fire the external auditor.

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a. True
b. False

ANSWER: True
POINTS: 1
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Enhanced Role of Audit Committees

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
LEARNING OBJECTIVES: AUDT.JOHN.16.02-06 - LO: 02-06
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Improved Corporate Governance

58. Audit committees of publicly traded companies must establish whistleblowing mechanisms within the company.

a. True
b. False

ANSWER: True
POINTS: 1
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Required Audit Firm Communication to the Audit Committee

59. Why is fraud detection an important part of the audit?

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
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Overview

60. One of the primary goals of the PCAOB is to restore confidence in which group?

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a. The SEC..
b. Boards of Directors.
c. Internal auditors.
d. Independent auditors..

ANSWER: d
POINTS: 1
LEARNING OBJECTIVES: AUDT.JOHN.16.02-04 - LO: 02-04
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: An Overview of the Auditor's Fraud-Related Responsibilities

61. Which of the following represents the size of company that has historically committed fraudulent financial reporting or that has experienced asset misappropriation by its employees?
a. Large corporations.
b. Middle-market corporations.
c. Small and start-up companies.
d. All companies.

ANSWER: d
POINTS: 1
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Magnitude of Fraud

62. What is the primary determinant in the 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
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Types of Frauds

63. Which of the following statements reflects an auditor’s responsibility for detecting fraud?
a. An auditor is not 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.

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ANSWER: d
POINTS: 1
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Auditor's Responsibility to Detect Fraud

64. 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 because the company will otherwise miss 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
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Types of Frauds

65. 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 a subsidiary from its consolidated results that it controls significantly.

ANSWER: d
POINTS: 1
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Types of Frauds

66. 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. Skimming.
b. Ponzi Scheme
c. Channel Stuffing.
d. Payroll Fraud.

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ANSWER: b
POINTS: 1
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Types of Frauds

67. 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
LEARNING OBJECTIVES: AUDT.JOHN.16.02-03 - LO: 02-03
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Recent History of Fraudulent Financial Reporting

68. Which of the following is a stated principle of a NYSE report identifying key core governance principles?
    a. Members of the Board of Directors should be primarily independent members.
    b. Effective corporate governance should be viewed as a compliance obligation.
    c. Effective corporate governance should be integrated with the company’s business strategy.
    d. The Board of Directors has the primary responsibility for creating a culture of integrity and ethical behavior.

ANSWER: c
POINTS: 1
LEARNING OBJECTIVES: AUDT.JOHN.16.02-06 - LO: 02-06
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Improved Corporate Governance

69. Which of the following is a specific corporate governance responsibility of Executive Management?
    a. Approving major changes, such as mergers..
    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
LEARNING OBJECTIVES: AUDT.JOHN.16.02-06 - LO: 02-06
NATIONAL STANDARDS: United States - BUSPORG: Analytic

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STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Improved Corporate Governance

70. 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. Implementing effective internal controls.
    d. Selecting the external audit firm.

ANSWER: b
POINTS: 1
LEARNING OBJECTIVES: AUDT.JOHN.16.02-06 - LO: 02-06
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Improved Corporate Governance

71. Who is most often involved in perpetrating fraudulent financial reporting?
    a. The auditors and the attorneys.
    b. The treasurer and the board of directors.
    c. The chief executive and chief financial officers.
    d. The shareholders and the chief operating officer.

ANSWER: c
POINTS: 1
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: User Expectations of Auditor Responsibility

72. What is the best way an auditor can detect fraud in the financial statements?
    a. Use professional skepticism.
    b. Understand Generally Accepted Accounting Standards.
    c. Brainstorm with the client to find the types of fraud occurring.
    d. Actively search for errors in the financial statements.

ANSWER: a
POINTS: 1
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Auditor's Responsibility to Detect Fraud

73. 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.

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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 not be aggressive in its initial approach to fraud as trust may be lost by the client.

ANSWER: b
POINTS: 1
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Auditor's Responsibility to Detect Fraud

74. What should an audit team do when it discovers that fraud risk factors are present on an audit engagement?
a. Retract from the client 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. Turn the audit over to forensic accountants.

ANSWER: b
POINTS: 1
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Auditor's Responsibility to Detect Fraud

75. The fraud triangle says three conditions are generally present in the client’s organization when fraud occurs. Which of the following is not one of those conditions?
a. Incentives.
b. Professional Skepticism.
c. Opportunity.
d. Ability to rationalize fraud.

ANSWER: b
POINTS: 1
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Auditor's Responsibility to Detect Fraud

76. Which of the following best represents actions that may indicate 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

Auditing A Risk Based-Approach to Conducting a Quality Audit 10th edition Johnstone Test Bank

NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Auditor's Responsibility to Detect Fraud

77. Which of the following best describes professional skepticism?
a. An intent to deceive.
b. An attitude of intrusion and obstinacy.
c. A character that does not waver.
d. A questioning mind.

ANSWER: d
POINTS: 1
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Fraud Risk Assessment and Detection Procedures

78. According to professional audit standards, how might an understanding of the nature of fraud that may occur in the client organization be identified by an audit firm?
a. Fraud training courses from actual corporate fraud ex-criminals.
b. Conducting a brainstorming session with the members of the audit team.
c. Circulating a survey to the client company employees for completion.
d. Discussions with other audit firms.

ANSWER: b
POINTS: 1
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Fraud Risk Assessment and Detection Procedures

79. Which of the following situations represents a risk factor that relates to misstatements arising from misappropriation of assets?
a. A high turnover of senior management.
b. A lack of independent checks.
c. A strained relationship between management and the predecessor auditor.
d. An inability to generate cash flow from operations.

ANSWER: b
POINTS: 1
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Fraud Risk Assessment and Detection Procedures

80. The Center for Audit Quality (CAQ) report identifies which of the following ways in which individuals involved in the financial reporting process can mitigate the risk of fraudulent financial reporting?

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a. Individuals involved in financial reporting need to 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. Individuals involved in financial reporting need to continually exercise professional skepticism.
c. Individuals involved in financial reporting need to remember that strong communication among those involved in the financial reporting process is critical.
d. All of the above.

ANSWER: d
POINTS: 1
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Fraud Risk Assessment and Detection Procedures

81. Which of the following frauds is most common?
a. Chief financial officer 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.

ANSWER: b
POINTS: 1
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Types of Frauds

82. 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
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Types of Frauds

83. Which of the following is a common incentive or condition which increases the likelihood for fraudulent financial reporting?
a. Ineffective segregation of assets.
b. Addictions to gambling or drugs.
c. Pending stock option expirations.
d. Access to undeposited cash.

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ANSWER: c
POINTS: 1
LEARNING OBJECTIVES: AUDT.JOHN.16.02-02 - LO: 02-02
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: The Fraud Triangle

84. Which of the following is not an element of the Fraud Triangle?
a. Incentive.
b. Rationalization.
c. Deception.
d. Opportunity

ANSWER: c
POINTS: 1
LEARNING OBJECTIVES: AUDT.JOHN.16.02-02 - LO: 02-02
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: The Fraud Triangle

85. Protection Transparency, Inc. is being audited by Messer and Bromely, LLP. During the assessment of fraud, 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. Protection Transparency's legal counsel.
b. The police.
c. The chairman of Protection Transparency's audit committee.
d. The predecessor auditor of Protection Transparency.

ANSWER: c
POINTS: 1
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Fraud Risk Assessment and Detection Procedures

86. 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 for increased operating income each month. Based upon the above information only, what type of probable motivation is there to commit fraud at the Premium Discovery Company?
a. Incentive.
b. Opportunity.
c. Rationalization.
d. Expectation.

ANSWER: a

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POINTS: 1
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Identify Fraud Risk Indicators

87. 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
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Identify Fraud Risk Indicators

88. Which of the following statements about the Bernie Madoff ponzi scheme is false?
a. Madoff too 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
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Identify Fraud Risk Indicators

89. Sam Jones, controller of Mitnikco, spends three days researching the accounting statements to find loopholes in the "rules" and to make a case for recognizing revenue earlier, rather than in later years. In the end, Sam and the other members of management determine that they will reduce the company's deferred revenue accounts and begin accounting for all revenues as agreements are signed. What are the motivations of Mitnikco management based solely on the information above?
a. Pressures.
b. Opportunity.
c. Rationalization.
d. Skepticism.

ANSWER: c
POINTS: 1

Auditing A Risk Based-Approach to Conducting a Quality Audit 10th edition Johnstone Test Bank

NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Identify Fraud Risk Indicators

90. There are many important reasons for diligent audit planning. If an audit firm wrongly 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
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Identify Fraud Risk Indicators

91. 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. The advent of new technology prevents fraud, thereby leading to less fraud over time.

ANSWER: a
POINTS: 1
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Identify Fraud Risk Indicators

92. 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
LEARNING OBJECTIVES: AUDT.JOHN.16.02-05 - LO: 02-05
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: The Sarbanes-Oxley Act of 2002

Auditing A Risk Based-Approach to Conducting a Quality Audit 10th edition Johnstone Test Bank

93. Which of the following frauds involved primarily asset misappropriation?
    a. Enron.
    b. Worldcom.
    c. Dell.
    d. Koss.

ANSWER: d
POINTS: 1
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Identify Fraud Risk Indicators

94. 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 the above.

ANSWER: d
POINTS: 1
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Linking Fraud Risk to Audit Procedures

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
POINTS: 1
LEARNING OBJECTIVES: AUDT.JOHN.16.02-05 - LO: 02-05
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: The Sarbanes-Oxley Act of 2002

96. The PCAOB has how many board members?
    a. Three
    b. Five
    c. Seven
    d. Nine

ANSWER: b

Auditing A Risk Based-Approach to Conducting a Quality Audit 10th edition Johnstone Test Bank

POINTS: 1
LEARNING OBJECTIVES: AUDT.JOHN.16.02-05 - LO: 02-05
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: The Sarbanes-Oxley Act of 2002

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
LEARNING OBJECTIVES: AUDT.JOHN.16.02-05 - LO: 02-05
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: The Sarbanes-Oxley Act of 2002

98. How often does the PCAOB inspect registered accounting firms that audit fewer than 100 issuers?
a. Annually
b. Every two years.
c. Every three years.
d. Every five years.

ANSWER: c
POINTS: 1
LEARNING OBJECTIVES: AUDT.JOHN.16.02-05 - LO: 02-05
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: The Sarbanes-Oxley Act of 2002

99. According to the Sarbanes-Oxley Act, which of the following items is the independent auditor required to report to the audit committee ?
a. Materiality limits for audit testing.
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
LEARNING OBJECTIVES: AUDT.JOHN.16.02-05 - LO: 02-05
NATIONAL STANDARDS: United States - BUSPORG: Analytic

Auditing A Risk Based-Approach to Conducting a Quality Audit 10th edition Johnstone Test Bank

STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: The Sarbanes-Oxley Act of 2002

100. Which action was a key element in the WorldCom audit fraud case?
a. Recording bartered exchange transactions as revenue.
b. Overstating cash by falsely recording cash 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
LEARNING OBJECTIVES: AUDT.JOHN.16.02-03 - LO: 02-03
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Recent History of Fraudulent Financial Reporting

101. Under the Sarbanes-Oxley Act, which of the following services performed by registered accounting firms for their audit clients would not impair their independence?
a. Systems design.
b. Tax services.
c. Appraisal services.
d. Internal audit services.

ANSWER: b
POINTS: 1
LEARNING OBJECTIVES: AUDT.JOHN.16.02-05 - LO: 02-05
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: The Sarbanes-Oxley Act of 2002

102. 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
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Using Audit Software for Fraud Identification

103. Which of the following statements is true concerning the fraud risk model?

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a. Assessing incentive is the first phase of the model.
b. The fraud risk model should be reviewed with the audit team.
c. The fraud risk model should be modified based on a review of internal controls.
d. Auditors do not use a fraud risk model.

ANSWER: d
POINTS: 1
LEARNING OBJECTIVES: AUDT.JOHN.16.02-04 - LO: 02-04
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: An Oveview of the Auditor's Fraud-Related Responsibilities

104. 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 independent directors.
d. CFOs must provide an annual certification of compliance with corporate governance standards.

ANSWER: b
POINTS: 1
LEARNING OBJECTIVES: AUDT.JOHN.16.02-06 - LO: 02-06
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Improved Corporate Governance

105. The fraud triangle has three components. Which of the components must be present for a fraud to occur?
a. All factors must be present for fraud to occur.
b. All factors need not be present.
c. Fraud can occur if any one of the factors is present.
d. None of the above

ANSWER: a
POINTS: 1
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Indicators of Fraud Risks

106. Which of the following best describes how corporate governance influences an organization?
a. To exert control over management.
b. To hold management accountable for its actions.
c. To exert control and require accountability for the resources entrusted to the organization.
d. To exert control over the internal control environment.

ANSWER: c

Auditing A Risk Based-Approach to Conducting a Quality Audit 10th edition Johnstone Test Bank

POINTS: 1
LEARNING OBJECTIVES: AUDT.JOHN.16.02-06 - LO: 02-06
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Improved Corporate Governance

107. 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
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Corporate Governance and Auditing

108. 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. Setting hiring policies for former employees of the external auditor.
c. Creating and implementing internal controls.
d. Discussing financial information provided to analysts.
ANSWER: c
POINTS: 1
LEARNING OBJECTIVES: AUDT.JOHN.16.02-06 - LO: 02-06
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Improving Corporate Governance

109. Which of following best describes the audit committee’s oversight responsibility?
a. Provide oversight of reporting outside the organization.
b. Provide oversight of internal auditing function.
c. Provide oversight of the external audit.
d. All of the above.
ANSWER: d
POINTS: 1
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Enhanced Role of Audit Committees

110. Which of the following facts should be communicated by the auditor to the audit committee?

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a. The auditor's responsibilities under GAAP.
b. Significant difficulties they had with management during the conduct of the audit..
c. Significant accounting policies.
d. All are required communications.

ANSWER: d
POINTS: 1
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Enhanced Role of Audit Committees

111. Which of the following is not one of management's responsibilities?
a. Ensuring accounting principles are following in preparing financial statements.
b. Engaging a qualified auditor.
c. Implementing effective internal controls.
d. Ensuring financial statements and disclosures are accurate.

ANSWER: b
POINTS: 1
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Corporate Responsibility for Financial Reporting

112. Which of the following are management responsibilities under the Sarbanes-Oxley Act of 2002?
a. Certify the accuracy of financial statements.
b. Establish a corporate code of conduct.
c. Designing internal controls.
d. All of the above.

ANSWER: d
POINTS: 1
LEARNING OBJECTIVES: AUDT.JOHN.16.02-05 - LO: 02-05
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: The Sarbanes-Oxley Act of 2002

113. **Fraud motivations and factors**

Research consistently shows that there are three factors associated with most frauds. List these factors and at least three indicators that the factor may exist for a particular company.

ANSWER:

Factor	**Indicators**
Incentives or Pressures	-Management compensation schemes. -Financial pressure to improve trends. -Personal need for financial enhancement. -Compliance with debt covenants.

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Opportunities	-Significant related-party transactions. -Industry dominance. -Influence over suppliers or customers. -Volume of subjective judgments by management. regarding valuation and other estimates. -Simple transactions made complex. -Complex or difficult to understand transactions (including SPEs/VIEs and derivatives). -Ineffective monitoring by management. -Complex or unstable organizational structure. -Weak or nonexistent internal controls. -Pushing accounting limits. -Aggressive accounting stance.
Attitudes or Rationalization	-Audit firm answers to management and not the audit committee. -Audit firm focus is on consulting for higher fees rather than audit services. -Stock analyst misguidance. -"The company owes me!"

POINTS: 1

NATIONAL STANDARDS: United States - BUSPORG: Analytic
United States - BUSPROG: Communication

STATE STANDARDS: United States - AK - AICPA BB-Critical thinking

TOPICS: Identify and analyze significant fraud risk factors

114. **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?

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 controls and potential effectiveness in mitigating the risk of fraud.
7. Respond, i.e. adjust 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.

Auditing A Risk Based-Approach to Conducting a Quality Audit 10th edition Johnstone Test Bank

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 starting with the step 1 through the completion of all of the steps identified above.

POINTS: 1
NATIONAL STANDARDS: United States - BUSPORG: Analytic
United States - BUSPROG: Communication
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Fraud Risk Assessment and Detection Procedures

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 taken criticism for failing to discover material frauds. Auditors have a greater 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, quite often, fraud in organizations usually takes place in one of three areas:
Asset misappropriation such as theft and misuse of assets.
Fraudulent financial reporting such as the overstatement of certain assets and revenues and the understatement of certain liabilities and expenses.
POINTS: 1
NATIONAL STANDARDS: United States - BUSPORG: Analytic
United States - BUSPROG: Communication
STATE STANDARDS: United States - AK - AICPA BB-Critical thinking
TOPICS: Types of Frauds

116. **PCAOB Independence Standards**

What are four requirements of the Sarbanes-Oxley that seek to protect auditor independence?
ANSWER: Sarbanes-Oxley: Auditor Independence

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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
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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TOPICS: Overview

117. **Enron: A Fraud Example**

What were the failures that allowed the Enron fraud to occur?

ANSWER: **Weak Management Accountabilit**y. Management was virtually not accountable to anyone as long as the company showed dramatic stock increases justified by earnings growth.
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. Accounting allowed practitioners to take obscure pronouncements, such as those dealing with Special Purpose Entities that were designed for leasing transactions, and apply the pronouncement 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

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revenue and profitability. Worse yet, auditors were hired by management who sometimes succeeded in pressuring auditors to acquiesce to aggressive financial reporting preferences.

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TOPICS: Major Frauds and Audit Procedures

118. **Fraud categories**

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

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TOPICS: Types of Frauds

119. **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 each year a 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
· 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

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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 periodic reviews of compliance with company policies such as corporate governance policies.

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TOPICS: Fraud Risks That May Lead to Material Misstatement

120. **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 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

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TOPICS: Auditor's Response to Fraud Risk Factors

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