

1.

Each of the following is a required characteristic of a review engagement of management's discussion and analysis (MD&A), except:

1. It consists principally of applying tests of details through inspection, observation, and confirmation.
2. The practitioner applies analytical procedures.
3. An objective is to report if any information came to the practitioner's attention that the MD&A is not reasonably presented.
4. The practitioner makes inquires of individuals responsible for financial matters.

ANSWER:

Choice "A" is correct. During the review engagement, the accountant typically does not perform tests of details. Tests of details are typically performed in an audit.

Choice "B" is incorrect. During the review engagement, the accountant should perform analytical procedures.

Choice "C" is incorrect. This is one of objectives of the review engagement of MD&A.

Choice "D" is incorrect. During the review engagement, the accountant should inquire with members of management who have responsibility for accounting and operational matters.

2.

Banister, a CPA, is approached by Wagner, a client. Wagner requests that Banister return the records provided to Banister by Wagner during an audit. Wagner still owes Banister the fees associated with the audit According to the AICPA Code of Professional Conduct, what should Banister do?

1. Banister should return the records to Wagner.
2. Banister should return the records to Wagner only after the fee has been paid.
3. Banister should not return the records to Wagner because the records now belong to Banister.
4. Banister should not return the records to Wagner without a court order.

ANSWER:

Choice "A" is correct. Banister does not own the records provided by Wagner. According to the AICPA Code of Professional Conduct, the auditor should return client’s records upon the client’s request.

Choice “B" is incorrect. According to the AICPA Code of Professional Conduct, withholding the client’s records after the client’s request is an act discreditable.

Choice "C" is incorrect. Banister does not own the records provided by Wagner.

Choice "D" is incorrect. In this situation, a court order is not necessary. The auditor should return client’s records upon the client’s request.

3.

An accountant's working papers for an engagement to review the financial statements of a nonpublic entity would be least likely to include which of the following forms of documentation?

1. Study and evaluation of internal control.
2. Explanation of analytical procedures performed.
3. A copy of the engagement letter.
4. Copies of representation letters from client management.

ANSWER:

Choice "A" is correct. During a review engagement, the accountant is required to understand the entity and its environment. However, the accountant is not required to obtain an understanding of the entity’s internal control or to test relevant internal control.

Choice “B” is correct. During a review engagement, analytical procedures should be designed to provide a basis for inquiry about the relationships and individual items that appear to be unusual and may indicate material misstatement.

Choice "C” is incorrect. In order to reduce the likelihood of misunderstanding, the accountant should agree upon the terms of the engagement with management or those charged with governance, as appropriate. Thus, an engagement letter should be included.

Choice "D" is incorrect. Written representations are necessary information that the accountant requires in connection with a review of the entity's financial statements.

4.

If differences of opinion arise between the engagement partner and the engagement quality control reviewer, then the engagement partner should:

1. Follow the firm's policies and procedures for resolving differences of opinion.
2. Issue a disclaimer of opinion and report the issue to the entity's audit committee.
3. Discuss the differences of opinion with the entity's management and issue a modified auditor's report.
4. Withdraw from the engagement when permissible under law or regulation.

ANSWER:

Choice "A" is correct. If the engagement partner and engagement quality control partner have different opinions, the engagement partner should follow the firm’s policies and procedures to resolve the difference.

Choice “B" is incorrect. A disclaimer of opinion should be expressed when 1) the auditor is unable to obtain sufficient appropriate audit evidence on which to base an opinion, and 2) the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive. A difference of opinion between the engagement partner and engagement quality control reviewer may not be indicative of either of those issues.

Choice "C" is incorrect. When different opinions arise, the engagement team would first follow the firm’s policies and procedures to resolve the difference. If differences still are unresolved, the accountant would likely discuss with the management and then with those charged with governance. The type of audit opinion would then depend on the materiality of the differences and pervasiveness of the issue.

Choice "D" is incorrect. When different opinions arise, the engagement team would first follow the firm’s policies and procedures to resolve the difference. Withdrawing from the engagement would be the last step after the engagement team exhaust all other attempts to resolve the differences.

5.

An accountant is reviewing the financial statements of a nonpublic entity in accordance with Statements on Standards for Accounting and Review Services (SSARS). The accountant most likely would perform which of the following procedures?

1. Obtain an understanding of the internal control structure.
2. Make inquiries about subsequent events.
3. Send bank account confirmations.
4. Perform limited tests of controls.

ANSWER：

Choice “B" is correct. During a SSARS review engagement, the accountant should inquiry with members of managements who have responsibility for accounting or operational matters. When the accountant becomes aware of information or evidence about subsequent events that require adjustment of, or disclosure in, the financial statements, the accountant should make inquires about subsequent events.

Choice "A" is incorrect. During a SSARS review engagement, the accountant is required to understand the entity and its environment. However, the accountant is not required to obtain an understanding of the entity’s internal control or to test relevant internal control.

Choice "C" is incorrect. This is an example of substantive audit procedures. During a SSARS review engagement, the accountant is not expected to perform substantive procedures.

Choice "D" is incorrect. During a SSARS review engagement, the accountant is required to understand the entity and its environment. However, the accountant is not required to obtain an understanding of the entity’s internal control or to test relevant internal control.

6.

Which of the following factors would an auditor most likely consider in evaluating the control environment for an audit client?

1. Monthly bank reconciliations with supervisor sign-offs.
2. The ethical values demonstrated by management.
3. Organizational structure used for tax purposes.
4. The number of employees in each department.

ANSWER:

Choice "B" is correct. The control environment sets the tone of an organization. The auditor should consider the following five principles related to the control environment: a commitment to integrity and ethical values; an independent board of directors; the organizational structure; a commitment to competence; and accountability.

Choice "A" is incorrect. Monthly bank reconciliations with sign-offs is an example of a control activity. Control activities are not specifically part of the control environment.

Choice "C" is incorrect. An entity’s organizational structure of the whole organization defines how authority and responsibility are delegated and monitored. However, the organizational structure for tax purposes may be different from the organizational structure of the whole organization.

Choice "D" is incorrect. The number of employees in each department may provide the auditor some helpful insight, however, it is not control environment.

7.

Which of the following factors represents an inherent limitation of internal control?

1. Absence of segregation of duties.
2. Failure to perform required tasks.
3. Mistakes resulting from human error.
4. Inadequate provisions to safeguard assets.

ANSWER:

Choice "C" is correct. Internal control provides only reasonable (not absolute) assurance regarding the achievement of objectives due to the following inherent limitations: 1) collusion, 2) overrode by management, 3) competence (Human judgment in decision making can be faulty and subject to bias) and 4) obsolescence.

Choice "A" is incorrect. Segregation of duties is the concept of having more than one person required to complete a task. A lack of segregation of duties would mean that some controls may not be appropriately designed.

Choice "B" is incorrect. A failure to perform required tasks indicates that the control may be effectively designed, but the individual(s) are not performing the activities as designed.

Choice "D" is incorrect. This would mean that some controls over the assets are not appropriately designed.

8.

When conducting a review engagement of a nonissuer, each of the following is considered an analytical procedure, except a comparison of the current-year's financial information to:

1. Expectations developed by the accountant.
2. Financial statements of a comparable prior period.
3. Supporting documentation.
4. Industry benchmarks.

ANSWER:

Choice "C" is correct. This is a substantive audit procedure.

Choice “A”, “B” and “D” are incorrect. They are all examples of analytical procedures. Analytical procedures are evaluations of financial information through analysis of plausible relationships among both financial and nonfinancial data.

9.

As part of risk assessment procedures for an audit of a nonissuer, an auditor would most likely perform which of the following procedures concerning related party transactions?

1. Evaluate the entity's procedures for identifying related party transactions.
2. Confirm related party transaction amounts and terms with the other party.
3. Perform a direct test of related party account balances.
4. Examine receiving and shipping records between the client and its affiliates.

ANSWER:

Choice "A" is correct. Risk assessment procedures are performed to obtain an understanding of the entity and its environment, including the entity's internal control, to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and relevant assertion levels. Thus, during this stage, an auditor would most likely obtain an understanding and evaluate the company's process (including controls) for identifying related parties, authorizing and approving transactions with related parties, and accounting for and disclosing relationships and transactions.

Choice "B", “C” and “D” are incorrect. They are substantive procedures. Before conducting substantive procedures, the auditor should obtain an understanding of the company's process for identifying related parties.

10.

Which of the following applications of sampling to test controls is most appropriate?

1. Testing a sample of customer orders for evidence of credit approval.
2. Testing a sample of controls to determine segregation of duties between inventory control and sales processing duties.
3. Testing a sample of accounts receivable confirmations.
4. Testing a sample of the budget center directors' allocation of annual budget to sales units.

ANSWER:

Choice "A" is correct. Auditors can select orders and inspect whether they have credit approval to test the operating effectiveness of credit approval.

Choice "B" is incorrect. Segregation-of-duties controls may not have easily accessible documentation. It is difficult for the auditor to sample for test work. The auditor would likely rely on inquiry or observation to test the operating effectiveness.

Choice "C” and “D” are incorrect. They are substantive procedures, not tests of controls.

11.

When evaluating the impact of potential litigation, an auditor of a nonissuer should obtain audit evidence about each of the following, except:

1. The period in which the underlying cause for legal action occurred.
2. The probability of an unfavorable outcome.
3. The probability that the matter will require a trial in court.
4. The amount or range of potential loss.

ANSWER:

Choice "C" is correct. It is not relevant to the auditor. Potential litigation represents a loss contingency. In accounting for loss contingencies, a professional judgment must be made related to the probability of occurrence of the future event (which will resolve the contingency) and the possibility of estimating the amount of the contingency. In addition, the period in which the underlying cause for legal action occurred will determine the reporting period.

Choice “A”, “B” and “D” are incorrect based on the above explanation.

12.

If a subsequent event occurs after the report date but prior to the release date of an audit report, resulting in management's revision of the financial statements of a nonissuer, then the auditor may do any of the following, except:

1. Maintain the original date of the report and state that the opinion is limited to the financial statements as they existed prior to the subsequent event.
2. Perform audit procedures necessary to obtain assurance about the revised financial statements.
3. Include an additional date in the audit report that is limited to the revision to the financial statements.
4. Revise the date of the audit report to reflect the necessity of additional audit procedures.

ANSWER:

Choice "A" is correct. In this situation, the auditor must extend audit tests for the newly discovered subsequent event to make sure that it is correctly disclosed. The auditor has two equally acceptable options for expanding subsequent events tests:

1. Expand all subsequent events tests to the new date. For this option, auditors simply change the audit report date to the new date. This option also extends the auditor's responsibility for all subsequent events to this later date.
2. Restrict the subsequent events review to matters related to the new subsequent event. For this option, the auditor issues a dual-dated audit report.

Choice ‘B”, “C” and “D” are incorrect based on the above explanation.

13.

A client holds a debt security that is actively traded in the market. Which of the following indicators would be the preferable guide to the security's fair market value?

1. Published price quotations in the market.
2. The price at which the debt security was purchased.
3. The cash flow model using discounted future cash flows.
4. Matrix pricing, in which published price quotations of similar debt securities are used to compute the fair market value.

ANSWER:

Choice "A" is correct. The fair value hierarchy is made up of three levels, with Level 1 being the highest level.

1. Level 1 inputs use unadjusted quoted prices in active markets for identical assets or liabilities that the entity can access at the measurement date.
2. Level 2 inputs would refer to quoted prices for similar assets or liabilities in all markets, adjusted as appropriate for differences.
3. Level 3 inputs are unobservable inputs for the asset or liability. Level 3 inputs may only be used to measure fair value if observable inputs are not available (i.e., there is little market activity for the asset or liability).

In this question, since the debt security is actively traded in the market, the published price quotations in the market should be used to determine the fair value of the investment.

Choice "B" is incorrect. This is the historical price.

Choice "C" is incorrect. This is Level 3 input.

Choice "D" is incorrect. This is Level 2 input.

14.

Which of the following most likely would be considered a mitigating condition concerning an entity's ability to continue as a going concern?

1. Plans to increase ownership equity.
2. Recent strong showing of the stock market.
3. Positive comments about the company from industry analysts.
4. A decreasing unemployment rate in the entity's industry.

ANSWER:

Choice "A" is correct. Mitigating factors usually include management’s plans to 1) dispose of an asset/business, 2) borrow money/restructure debt, 3) reduce/delay expenditures and 4) increase ownership equity.

Choice "B", “C” and “D” are incorrect. They are all things that management cannot control. The mitigating factor must include both management's intent and ability to carry out the plans.

15.

Whose signatures should be included in the management representation letter to the auditor?

1. President and chief financial officer
2. Chairman of the audit committee and chief operating officer
3. Corporate secretary and treasurer
4. Chief information officer and chief operating officer

ANSWER:

Choice "A" is correct. A representation letter documents management’s most important oral representations made during the audit. The letter is prepared on the client’s letterhead, addressed to the CPA firm, and signed by high-level corporate officials, usually the president and chief financial officer.

Choice "B", “C” and “D” are incorrect. These people would not be responsible for many items included in the letter.

