

RMIT

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Chapter 1: Introduction and overview of audit and assurance

True/False

1. An auditor can provide a reasonable level of assurance on information other than historical financial information.

- *a. True
- b. False

Correct answer: a

2. A no assurance engagement is of little use as no assurance is given to the client.

- a. True
- *b. False

Correct answer: b

3. A compliance audit involves gathering evidence to ascertain whether the person or entity under review has followed the rules, policies, procedures, laws and regulations with which they must conform

- *a. True

- b. False

Correct answer: a

4. An operational audit is an example of a compliance audit.

- a. True
*b. False

Correct answer: b

5. The most common types of assurance engagements are financial report audits, confirmation audits, performance audits, comprehensive audits and assurance on corporate social responsibility (CSR) disclosures.

- a. True
*b. False

Correct answer: b

6. A reasonable level of assurance is the highest level of assurance that an auditor can provide.

- *a. True
b. False

Correct answer: a

7. A negative expression of opinion is only given when there is a disagreement with management and the auditor.

- a. True
*b. False

Correct answer: b

8. All modified audit reports are qualified audit opinions.

- a. True
*b. False

Correct answer: b

9. The nature of audit procedures refers to the reliance on evidence provided by the client and its management.

- *a. True
- b. False

Correct answer: a

10. It is the auditor's responsibility to prepare the financial statements.

- a. True
- *b. False

Correct answer: b

11. Only current investors (not potential investors) are considered to be users of the financial statements.

- a. True
- *b. False

Correct answer: b

12. Insurance hypothesis is a means whereby the investor can guarantee the success of their investment.

- a. True
- *b. False

Correct answer: b

13. International Auditing and Assurance Standards Board (IAASB) is not responsible for the redrafting of International Auditing Standards (ISAs) to Australian Auditing Standards (ASAs).

- *a. True
- b. False

Correct answer: a

14. You must complete further study after a bachelor's degree to become a member of the ICAA, CPA Australia or the NIA.

- *a. True
- b. False

Correct answer: a

15. The expectation gap is caused by unrealistic user expectations such as the auditor providing a moderate level of assurance.
- a. True
 - *b. False

Correct answer: b

16. An assurance engagement is performed by an auditor or consultant to enhance the reliability of the subject matter

- *a. True
- b. False

Correct answer: a

17. An audit engagement is performed by an Auditor to provide a reasonable assurance that the financial report gives a true and fair view of the business activities for the period.

- *a. True
- b. False

Correct answer: a

18. An audit of a financial report by the contracted auditors will give absolute assurance that the financial reports give a true and fair view of the financial performance of the entity.

- a. True
- *b. False

Correct answer: b

Multiple Choice Questions

19. An assurance engagement can be defined as
- *a. an engagement to enhance the reliability of the subject matter
 - b. an engagement of an expert to direct the entity on subject matter
 - c. an audit to determine the validity of the subject matter
 - d. an engagement to determine a true and fair view of the entities course of actions

Correct answer: a

Learning Objective 1.1 ~ Define an assurance engagement

20. An example of the three parties in an assurance engagement would be:
- a. audit client, employee, customer
 - *b. audit client, supplier, auditor
 - c. auditor, shareholder, general public
 - d. auditor, general public, employees.

Correct answer: b

Learning Objective 1.1 ~ Define an assurance engagement

21. A limitation of an audit is caused by
- a. the nature of financial reporting
 - b. the nature of audit procedures
 - c. the need for the audit to be conducted within a reasonable period of time and at a reasonable cost
 - *d. all of the above.

Correct answer: d

Learning Objective 1.2 ~ Differentiate between different types of assurance services

22. Which of the following is NOT true about Corporate Social Responsibility assurance?
- a. reporting is voluntary and is becoming more widespread.
 - b. includes both financial and non-financial information.
 - *c. is required to be performed by an auditor.
 - d. disclosures include environmental, employee and social reporting.

Correct answer: c

Learning Objective 1.2 ~ Differentiate between different types of assurance services

23. When auditors are engaged in work where no assurance is provided this means;
- a. That the review indicates adverse finding and the auditors are not prepared to give an assurance that the information gives a true and fair view.
 - b. The auditors found anomalies in the financial information and no assurance will be given until further testing is conducted
 - *c. An assurance is not provided as the client determines the nature, timing and extent of the evidence that is gathered and will determine their own outcome
 - d. No assurance is provided as the client will determine the outcome once the auditors have gathered the correct data.

Correct answer: c

Learning Objective 1.3 ~ Explain the different levels of assurance

24. Which of the following would be an example of a reasonable assurance engagement?
- a. the review of annual financial statements.
 - *b. the audit of annual financial statements.
 - c. the reporting of procedures performed by the auditor as agreed by the client.
 - d. all of the above.

Correct answer: b

Learning Objective 1.3 ~ Explain the different levels of assurance

25. The wording of a negative expression of opinion generally states that:
- a. there is nothing wrong with the subject matter.
 - b. there is something wrong with the subject matter.
 - *c. there is nothing that has come to the auditor's attention that would lead them to believe that the information being assured is not true and fair.
 - d. there is something that has come to the auditor's attention that would lead them to believe that the information being assured is not true and fair.

Correct answer: c

Learning Objective 1.4 ~ Outline different audit opinions

26. In a review engagement, which of the following is least likely to occur during the engagement?
- a. analytical procedures
 - b. enquiries with management and other personnel
 - *c. substantive audit procedures
 - d. review of the internal controls of the entity.

Correct answer: c

Learning Objective 1.3 ~ Explain the different levels of assurance

27. An example of an unmodified audit opinion is:
- a. qualified audit opinion
 - b. adverse audit opinion
 - *c. unqualified audit opinion with an emphasis of matter.
 - d. none of the above.

Correct answer: c

Learning Objective 1.4 ~ Outline different audit opinions

28. Which of the following is not a type of opinion?
- a. qualified opinion
 - *b. modified opinion
 - c. adverse opinion
 - d. disclaimer of opinion

Correct answer: b

Learning Objective 1.4 ~ Outline different audit opinions

29. The following can be said about an emphasis of matter:
- a. it is included when the auditors opinion has changed and the auditor wants to bring the users' attention to a particular matter.
 - b. it is only used in unqualified audit opinions.
 - *c. it is included when the auditor's opinion has not changed and the auditor wants to bring the users' attention to a particular matter.
 - d. it cannot be used when expressing audit opinion that has pervasive misstatements.

Correct answer: c

Learning Objective 1.4 ~ Outline different audit opinions

30. In addition to the preparation of financial statements, it is also the responsibility of those charged with governance to:
- a. identify the financial reporting framework to be used in the preparation and presentation of their financial report.
 - b. establish and maintain internal controls that are effective in preventing and detecting material misstatements
 - c. selecting and applying appropriate accounting policies and making reasonable accounting estimates
 - *d. all of the above.

Correct answer: d

Learning Objective 1.5 ~ Differentiate between the different role of the preparer and the auditor, and discuss the different firms that provide assurance services

31. Which of the following is not true in relation to comparability?
- a. able to identify trends that may influence their perception of how well the entity is doing.
 - b. able to assess performance of the entity over time and with other entities
 - c. able to evaluate
 - *d. all of the above are correct.

Correct answer: d

Learning Objective 1.5 ~ Differentiate between the different role of the preparer and the auditor, and discuss the different firms that provide assurance services

32. Professional scepticism does not involve:
- *a. the professional requirement that all management representations be substantiated with supporting documentation.
 - b. seeking independent evidence to corroborate information provided by their client
 - c. being suspicious when evidence contradicts documents held by their client or enquiries made of client personnel
 - d. none of the above.

Correct answer: a

Learning Objective 1.5 ~ Differentiate between the different role of the preparer and the auditor, and discuss the different firms that provide assurance services

33. The largest accounting firms in Australia are known collectively as the
- a. 'Big-3'
 - *b. 'Big-4'
 - c. 'Big-5'
 - d. 'Big-6'

Correct answer: b

Learning Objective 1.5 ~ Differentiate between the different role of the preparer and the auditor, and discuss the different firms that provide assurance services

34. Under CLERP9, which of the following is not correct relating to specific disclosures in the directors report?
- a. details of the amount paid or payable to the company's auditor for non-audit services (each non-audit service must be listed separately along with the amount paid or payable for that service)
 - b. if the directors are satisfied that auditor independence has not been impacted by the provision of non-audit services, a statement of the directors' reasons for being satisfied.
 - *c. disclosure of material transactions between auditor and entity during the period under audit.
 - d. a statement whether the directors are satisfied that the provision of non-audit services by the auditor impacts the auditor's independence

Correct answer: c

Learning Objective 1.5 ~ Differentiate between the different role of the preparer and the auditor, and discuss the different firms that provide assurance services

35. Suppliers as a user of the financial statements would least consider which of the following aspects of the financial statements:
- a. solvency of the entity
 - b. profitability of the entity
 - *c. return on investment of the entity
 - d. corporate social responsibility of the entity

Correct answer: c

Learning Objective 1.6 ~ Explain why there is a demand for audit and assurance services

36. Which of the following is incorrect? A government can be considered to be a user of the general purpose financial reports because:
- *a. it is the basis for the calculation of taxes owed to the government
 - b. it can determine whether certain regulations have been complied with
 - c. to gain a better understanding of the entities activities
 - d. to assess the entity so that it can provide the entity with grants that will benefit society.

Correct answer: a

Learning Objective 1.6 ~ Explain why there is a demand for audit and assurance services

37. Agency theory can be described as the theory of:
- a. hiring an agency to review the work of the management, in this case it is the auditor.
 - b. when the finance function is outsourced to an outside party, and the auditor is required to audit the outside party's work.
 - *c. the relationship between the owner and the management of the business when the owner is not the manager of the business.
 - d. none of the above.

Correct answer: c

Learning Objective 1.6 ~ Explain why there is a demand for audit and assurance services

38. Insurance hypothesis tells us that:
- *a. investors will demand that financial reports be audited as a way of insuring against some of their loss should their investment fail.
 - b. investors can insure themselves against loss by investing in a diverse investment portfolio should an individual investment fail.
 - c. investors cannot insure themselves against loss when investing in an entity.
 - d. the entity can take out insurance to protect itself from such risks as employee or management fraud which can lead to material misstatements in the financial statements.

Correct answer: a

Learning Objective 1.6 ~ Explain why there is a demand for audit and assurance services

39. Which of the following regulators do not impact on the audit process?
- a. Australian Securities and Investments Commission (ASIC)
 - b. National Institute of Accountants (NIA)
 - *c. Auditing Professional and Ethical Standards Board (APESB)
 - d. all of the above have an impact on the audit process.

Correct answer: c

Learning Objective 1.7 ~ Identify the different regulators and regulations surrounding the assurance process

40. The objective of the Financial Reporting Council does not include:
- a. to oversee the process used for setting accounting and auditing standards
 - b. to monitor and report regularly on matters concerning auditor independence
 - *c. to be involved in the technical issues around the standard-setting process.
 - d. all of the above are included in the objectives of the Financial Reporting Council

Correct answer: c

Learning Objective 1.7 ~ Identify the different regulators and regulations surrounding the assurance process

41. Which of the following is correct? The Accounting Professional Ethical Standards Board (APESB):
- *a. standards are required to be complied with by members of each of ICAA, CPA and NIA.
 - b. issue technical standards to the members of the ICAA, CPA Australia and NIA.
 - c. follows pronouncements issued by the International Accountants Ethics Standards Board (IAESB)
 - d. have not approved any standards that are required by law.

Correct answer: a

Learning Objective 1.7 ~ Identify the different regulators and regulations surrounding the assurance process

42. Which of the following is incorrect? The Australian Securities and Investments Commission (ASIC)
- a. registers auditors and processes annual statements from registered auditors
 - *b. requires all auditors' financial statements to be independently audited annually
 - c. provides a whistleblowing facility for the reporting of contraventions of the Corporations Act
 - d. enforces independence requirements for auditors

Correct answer: b

Learning Objective 1.7 ~ Identify the different regulators and regulations surrounding the assurance process

43. The Companies and Liquidators Disciplinary Board can respond to applications made by:
- a. the Australian Securities and Investments Commission (ASIC)
 - b. the Australian Prudential Regulation Authority (APRA)
 - *c. the Australian Securities and Investments Commission (ASIC) or the Australian Prudential Regulation Authority (APRA)
 - d. the general public

Correct answer: c

Learning Objective 1.7 ~ Identify the different regulators and regulations surrounding the assurance process

44. Auditor rotation in CLERP9 states that an auditor cannot perform a significant role in the audit of a client in more than
- a. two out of five years
 - b. two out of seven years
 - *c. five out of seven years
 - d. six out of seven years

Correct answer: c

Learning Objective 1.7 ~ Identify the different regulators and regulations surrounding the assurance process

45. The expectation gap is caused by:
- a. realistic auditor expectations
 - *b. unrealistic user expectations
 - c. realistic user expectations
 - d. unrealistic auditor expectations

Correct answer: b

Learning Objective 1.8 ~ Describe the audit expectation gap

46. The expectation gap can be reduced by:
- a. auditors performing their duties properly
 - b. enhanced reporting to explain what processes have been followed in arriving at an audit or a review opinion
 - c. assurance providers reporting accurately the level of assurance being provided
 - *d. all of the above.

Correct answer: d

Learning Objective 1.8 ~ Describe the audit expectation gap

Short Answer Questions

47. The main assurance service the general public are familiar with are financial report audits. Briefly describe the other services that an auditor can provide.

Answer: Learning Objective 1.2 ~ Differentiate between different types of assurance services.
A compliance audit involves gathering evidence to ascertain whether the person or entity under review has followed the rules, policies, procedures, laws and regulations with which they must conform.

Performance audits are concerned with the economy, efficiency and effectiveness of an organisation's activities

A comprehensive audit may encompass elements of a financial report audit, a compliance audit and a performance audit.

Internal audits are conducted to provide assurance about various aspects of an organisation's activities.

Corporate social reporting disclosures include environmental, employee and social reporting.

48. Outline the reasons for the demand for assurance services.

Answer: Learning Objective 1.6 ~ Explain why there is a demand for audit and assurance services.

Remoteness – As most users do not have access to the entity under review, this makes it difficult to determine whether the information contained in the report is a fair presentation of the entity and its activities for the relevant period.

Complexity – Most financial report users do not have the accounting and legal knowledge to enable them to assess the complex accounting and disclosure choices being made by the entity.

Competing incentives – management may have their own incentives to present the information in a particular light which may help them achieve their own objectives. This may introduce bias in what is being presented.

Reliability – As the information is being depended upon to make important decisions, it is important that the information being presented is reliable

49. How is the expectation gap caused and how can the effects expectation gap be reduced?

Answer: *Learning Objective 1.8 ~ Describe the audit expectation gap.*

In particular, the gap is caused by unrealistic user expectations such as:

- the auditor is providing complete assurance
- the auditor is guaranteeing the future viability of the entity
- an unqualified (clean) audit opinion is an indicator of complete accuracy
- the auditor will definitely find any fraud
- the auditor has checked all transactions.

The expectation gap can be reduced by:

- auditors performing their duties appropriately, complying with auditing standards and meeting the minimum standards of performance that should be expected of all auditors;
- peer reviews of audits to ensure that auditing standards have been applied correctly;
- auditing standards being reviewed and updated on a regular basis to enhance the work being done by auditors;
- education of the public
- enhanced reporting to explain what processes have been followed in arriving at an audit (reasonable assurance) or a review (limited assurance) opinion (significant improvements have been introduced by standard setters improving assurance reporting); and
- assurance providers reporting accurately the level of assurance being provided (reasonable, limited or none).

Essay Questions

50. There have been a number of high profile corporate collapses in the past decade both in Australia and overseas. What role does society expect from auditors in ensuring this does not happen? What can auditors do to manage this expectation?