Knowledge Checks: Multiple Choice and Extended Response Questions and Solutions

ADVANCED AUDIT AND ASSURANCE

Version 16a

© Copyright CPA Australia unless otherwise indicated.

Multiple Choice Questions and Solutions

Contents

Questions

Module 1

Question 1.1

Which **one** of the following statements **best** describes the term 'assurance services'?

A The assembly of financial statements based on assumptions of a responsible party.
B Services designed for the improvement of operations, resulting in better outcomes.
C Services designed to express an opinion on historical financial statements based on the results of an audit.
D Independent professional services that improve the credibility of information, or its context, for decision-makers.

(AAA ID 1.1)

Question 1.2

The *International Framework for Assurance Engagements* indicates that, in practice, a professional accountant should be able to provide which **one** of the following levels of assurance on various engagements?

A absolute
B high or low
C appropriate
D reasonable or limited

(AAA ID 1.2)

Question 1.3

For an assurance engagement with respect to the cash budgets of XYZ Ltd (XYZ) for CDE Bank Ltd (CDE), the responsible party would be

A the shareholders of XYZ.
B the management of XYZ.
C the shareholders of CDE.
D the management of CDE.

(AAA ID 1.3)

Question 1.4

Which of the following actions would be considered as self-interest threats?

Select which **two** options are correct.

A One client provides a high percentage of total audit fees.
B A member of the assurance team is a director of the client.
C An auditor has potential employment with an assurance client.
D An auditor acts as an advocate on behalf of an assurance client.

(AAA ID 1.4)

Question 1.5

Which **one** of the following fundamental principles of professional conduct is under threat when an accountant prepares an advertisement comparing the quality of their work with that of other accountants in the local region?

A objectivity
B professional behaviour
C professional scepticism
D professional competence and due care

(AAA ID 1.5)

Question 1.6

Which of the following are self-interest threats to objectivity?

Select which **two** options are correct.

A receiving gifts from clients
B competing directly with the client
C personal friendship with the CEO and CFO of the client
D auditing a client when your firm redesigned the internal control system in the previous year

(AAA ID 1.6)

Question 1.7

Which of the following statements are correct?

Select which **two** options are correct.

A Professional scepticism implies an expectation of fraud or error, so is a biased viewpoint.
B The level of professional scepticism needs to be maintained throughout the whole engagement.
C Professional scepticism is important in considering management's explanations for unusual trends.
D The level of professional scepticism can be reduced where the auditor has past experience with the entity indicating the honesty and integrity of management.

(AAA ID 1.7)

Question 1.8

Which of the following statements are true?

Select which **two** options are correct.

A Reviews of historical financial information are limited assurance engagements.
B A review engagement does not ordinarily require tests of accounting records through inspection, confirmation and observation.
C A practitioner who is the auditor of an entity cannot also carry out a review engagement for the same client in the same year.
D A common form of expression for a review engagement is 'The financial statements are prepared in accordance with the [appropriate accounting] framework'.

(AAA ID 1.8)

Question 1.9

An auditor leaves an audit firm and takes the role of the CFO of an audit client two months after completing the audit. This would involve some of the following threats.

Select which **three** options are correct.

A familiarity
B self-review
C self-interest
D intimidation

(AAA ID 1.9)

Question 1.10

For a financial audit of a government department carried out by an Auditor-General's office, which of the following would be outputs of the audit?

Select which **three** options are correct.

A an audit opinion on the financial statements
B a report to parliament on significant issues arising out of the audit
C an opinion on whether taxpayers' money is spent efficiently, effectively and economically
D a letter to the governing body of the auditee that includes observations about the quality of internal controls

(AAA ID 1.10)

Question 1.11

Which **one** of the following is **most likely** to be a direct engagement?

A a performance audit
B a financial statement audit
C a review of prospective financial information
D an assurance engagement of a sustainability report which was prepared by management

(AAA ID 1.11)

Question 1.12

Which of the following potential criteria could be used in an internal control assurance engagement?

Select which **two** options are correct.

A international accounting standards
B COSO (2013) *Internal Control—Integrated Framework*
C criteria developed by the practitioner for the purpose of the engagement
D ISA 265 *Communicating Deficiencies in Internal Control to Those Charged with Governance and Management*

(AAA ID 1.12)

Question 1.13

What type of threat to professional independence identified in the *Code of Ethics for Professional Accountants* is created when the auditor is given a discount on wine purchases by a client that operates a winery?

A financial threat
B self-review threat
C self-interest threat
D intimidation threat

(AAA ID 1.13)

Module 2

Question 2.1

According to ISA 200 *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*, reasonable assurance is obtained when the auditor has reduced audit risk to

A a reasonable level.
B an acceptable level.
C a reasonably low level.
D an acceptably low level.

(AAA ID 2.1)

Question 2.2

Which **one** of the following statements is correct?

A Audit risk is the risk of a material misstatement in the financial statements.
B The risk of a material misstatement in the financial statements consists of control risk.
C Audit risk is the risk that the auditor will not detect a material misstatement that exists in the financial statements.
D Audit risk is the risk of a material misstatement in the financial statements and that the auditor did not detect the material misstatement.

(AAA ID 2.2)

Question 2.3

Which of the following increase control risk?

Select which **two** options are correct.

A lack of segregation of duties
B optimistic forecasts presented to analysts
C reduction in sample size for substantive tests
D reduction in the size of the internal audit group

(AAA ID 2.3)

Question 2.4

ISA 240 *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements* specifically requires the auditor, when identifying and assessing the risk of material misstatement due to fraud, to presume there is a risk of fraud in

A revenue recognition.
B weak internal controls.
C liability understatement.
D misappropriation of assets.

(AAA ID 2.4)

Question 2.5

Which **one** of the following does **not** impact on inherent risk?

A The auditor has reduced the sample sizes for testing of purchases for the entity.
B The entity has purchased its raw materials from the United States at discounted prices.
C During the year, the entity converted its computer system to a new improved online system.
D Management has introduced a new bonus scheme for sales employees who meet their monthly target.

(AAA ID 2.5)

Question 2.6

In which of the circumstances below would an auditor be able to change the terms of engagement from an audit to a review engagement?

Select which **two** options are correct.

A A change in circumstances affects the entity's requirements.
B There is a misunderstanding concerning the nature of the service originally requested.
C During the audit, the auditor is unable to obtain sufficient appropriate evidence with respect to receivables.
D The client has substantial assets in Iraq. Due to an ongoing conflict, the auditor is unable to test the existence or value of the assets.

(AAA ID 2.6)

Question 2.7

XYZ Ltd (XYZ) is a listed company with an audit committee comprising three of the eight board members.

XYZ's auditor would communicate matters of governance with

A management only.
B management, audit committee and the board of directors.
C either the audit committee, the board of directors or both.
D only the audit committee and never the full board of directors.

(AAA ID 2.7)

Question 2.8

With respect to financial statement fraud, which **one** of the following statements is **not** correct?

A Enquiries of management are more useful for detecting management fraud than employee fraud.
B The auditor must consider the risk of material fraud at both the financial statement level and the assertion level.
C Excessive pressure on management to meet expectations of third parties creates incentives for management fraud.
D The auditor needs to consider the likelihood of collusion in determining the appropriate level to report suspicions of fraud.

(AAA ID 2.8)

Question 2.9

Which **one** of the following statements is true with respect to the terms of audit engagements?

A For an audit of financial statements, a new engagement letter must be sent each year.
B The auditor must obtain assurance from management that the financial statements are free from material misstatement.
C If the auditor receives a request to change the engagement from an audit to a review because of a misunderstanding about the nature of an audit by the auditee, this would normally be considered a reasonable basis for requesting a change.
D If the auditor receives a request to change the engagement from an audit to a review because of reduction in the scope of the audit caused by management, this would normally be considered a reasonable basis for requesting a change.

(AAA ID 2.9)

Question 2.10

The balance date for the auditee is 30 June 20X0. Based on preliminary work carried out at the planning stage, the auditor decides to move all substantive testing of inventory to 30 June, instead of the original planned date of 31 May. Which of the following risks would be reduced?

Select which **two** options are correct.

A audit
B control
C inherent
D detection

(AAA ID 2.10)

Question 2.11

Which **one** of the following procedures would normally be carried out by the engagement quality control reviewer?

A participation in the planning of the audit
B review and approval of the audit program
C review of significant judgments made by the engagement team
D ensure that all evidence collected by the audit team is valid and reliable

(AAA ID 2.11)

Question 2.12

Which of the following would need to be documented with respect to a sample of purchase orders?

Select which **three** options are correct.

A the population from which the purchase orders came
B the unique numbers of the purchase orders examined
C the supplier of the inventory items identified on the purchase order
D the starting point and sample interval of the purchase orders selected

(AAA ID 2.12)

Question 2.13

Which of the following are financial statement frauds?

Select which **three** options are correct.

A forging of accounting records
B unintentional omission from the financial statements of transactions
C intentional misapplication of accounting principles related to amounts
D intentional misapplication of accounting principles related to disclosure

(AAA ID 2.13)

Question 2.14

Prior to accepting an appointment as auditor, the audit firm is informed by management that management does not believe it is responsible for the internal control system.

As a result of this information, the auditor

A cannot accept the audit engagement unless required to do so by law or regulation.
B will not be able to rely on internal controls and will need to carry out substantive tests of details and analytical procedures.
C will need to increase the extent of tests of controls, as well as consider the nature and timing of these tests in order to rely on internal controls.
D must inform management that unless management acknowledges its responsibility for the internal control system it will be considered a 'limitation of scope' on the audit.

(AAA ID 2.14)

Question 2.15

Which of the following statements are correct?

Select which **two** options are correct.

A Some ISAs may not be relevant to small entities.
B ISAs do not apply to companies limited by guarantee.
C Specific audit procedures to comply with ISAs may vary depending on the size of the entity.
D In some instances, the Australian auditing standards permit auditors to ignore the requirements of the ISAs.

(AAA ID 2.15)

Question 2.16

Which **one** of the following statements about fraud is correct?

A Fraud can be intentional or unintentional.
B Fraud always involves misappropriation of assets.
C Fraud always involves the use of deception to obtain an unjust or illegal advantage.
D Fraud is always perpetrated by management, those charged with governance or employees.

(AAA ID 2.16)

Question 2.17

Which **one** of the following does **not** necessarily constitute fraud?

A Alteration of accounting records from which the financial statements are prepared.
B Overriding internal controls to record transactions outside the usual course of an entity's business.
C Intentional omission from the financial statements of transactions or other significant information.
D Intentional misapplication of accounting principles relating to amounts, classification, manner of presentation or disclosure.

(AAA ID 2.17)

Question 2.18

Which **one** of the following fraudulent activities constitutes misappropriation of assets?

A causing an entity to pay for goods and services not received
B omitting, advancing or delaying recognition of events and transactions
C concealing, or not disclosing, facts that could affect the recorded amounts
D engaging in complex transactions that misrepresent the financial position of the entity

(AAA ID 2.18)

Question 2.19

You are the auditor of Client Co and have commenced planning for the 20X9 audit engagement. As part of your planning activities, you have asked the CEO about important events during the year that might have an impact on the audit. In response, he has asked you to 'take it easy' on the chief financial officer because his son is seriously ill. Apparently, the child must travel regularly to the United States for expensive medical treatments.

What fraud risk factors are present in this situation?

A incentive and opportunity
B incentive and rationalisation
C opportunity and rationalisation
D incentive, opportunity and rationalisation

(AAA ID 2.19)

Question 2.20

Which **one** of the following does **not** constitute an appropriate audit planning procedure that the auditor should employ relating to the risk of fraud?

A Increase the level of professional scepticism.
B Make enquiries to obtain information and so identify the risks of material misstatement due to fraud.
C Incorporate an element of unpredictability in the selection of the nature, timing and extent of the audit procedures to be performed.
D The engagement team needs to discuss the susceptibility of the entity's financial statements to material misstatement due to fraud.

(AAA ID 2.20)

Question 2.21

The auditor of Client Co has made enquiries about a related party transaction identified in the notes to the financial statements. The auditor has discovered that the CEO of Client Co is the owner of a manufacturing company that is a major supplier to Client Co.

What is your assessment of the risk of fraud associated with this transaction?

A medium, because incentive is absent
B medium, because opportunity is absent
C medium, because rationalisation is absent
D high, because incentive, opportunity and rationalisation are all present

(AAA ID 2.21)

Question 2.22

When planning the audit, the auditor must make enquiries of management.

Which **one** of the following is **not** an appropriate enquiry of management about fraud?

A The auditor should ask about management's communications with employees about ethical behaviour.
B The auditor should ask management about their assessment of the risk that the financial statements may be materially misstated due to fraud.
C The auditor should ask management if they are personally engaged in fraudulent activity, including fraudulent financial reporting and misappropriation of assets.
D The auditor should ask management about any communications with those charged with governance regarding its processes for identifying and responding to the risks of fraud in the entity.

(AAA ID 2.22)

Question 2.23

Which **one** of the following circumstances would **not** be included in the auditor's communication with those charged with governance about matters related to fraud?

A a failure by management to respond to an identified fraud
B the absence of a risk assessment process for violations of labour laws
C a list of store locations where inventory turnover is significantly higher than average
D a failure by management to address identified material weaknesses in internal control

(AAA ID 2.23)

Question 2.24

Your Australian audit client has informed you that they will be winding up their business within the next eight to 12 months and has asked whether this will have an effect on the financial statements.

Which **one** of the following statements **best** describes the financial reporting requirements in this situation?

A There are no implications for the financial statements because the business will continue in operation for up to 12 months.
B The auditor will have to issue a disclaimer of opinion because the value of the firm's assets and liabilities cannot be determined.
C The balance sheet must be prepared to show the liquidation values of the assets and liabilities because the going concern basis is no longer appropriate.
D The financial statements should include a note disclosing the fact that the business will cease to operate. An Emphasis of Matter paragraph will be included in the auditor's report, drawing the reader's attention to this disclosure.

(AAA ID 2.24)

Question 2.25

Which **one** of the following **best** describes the auditor's responsibilities in evaluating the appropriateness of the going concern assumption?

A The auditor's responsibility is to consider the going concern assumption only when potential problems appear.
B The auditor should evaluate management's assessment of the appropriateness of the going concern assumption.
C The auditor should collect information and make his/her own evaluation of the appropriateness of the going concern assumption.
D The auditor should ask management about its plans to deal with problems relating to the business's ability to continue as a going concern.

(AAA ID 2.25)

Question 2.26

Which of the following reasons are provided by the auditing standards to explain why an audit does **not** provide absolute assurance?

Select which **three** options are correct.

A Most evidence is persuasive, not conclusive.
B Fraud may involve sophisticated attempts to conceal it.
C Difficulties exist in operationalising professional scepticism.
D Some financial statement items are subject to an inherent level of variability, which cannot be eliminated by additional audit procedures.

(AAA ID 2.26)

Module 3

Question 3.1

In assessing which risks are significant risks under ISA 315 (revised) *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*, which **one** of the following is **not** required to be considered by the auditor?

A the complexity of transactions
B whether the risk is a risk of fraud
C whether the firm has an internal audit department
D the degree of subjectivity in the measurement of financial information

(AAA ID 3.1)

Question 3.2

Business risk may arise from which of the following?

Select which **three** options are correct.

A globalisation
B industry and economic factors
C corporate objectives and strategies
D when the CFO fails to ensure bank reconciliations are completed

(AAA ID 3.2)

Question 3.3

An auditor's preliminary analysis of accounts receivable turnover of North Star Pty Ltd revealed the following ratios.

20X9	20X8	20X7
4.3 times	6.2 times	7.3 times

Which **one** of the following is the **most likely** cause of the decrease in accounts receivable turnover?

A increased cash sales
B relaxation of credit policy
C shortening of due date terms
D increase in the cash discount offered

(AAA ID 3.3)

Question 3.4

Which **one** of the following would result in an increase in the entity's business risk?

A increase in interest rates
B decrease in sample sizes
C decrease in inflation rate
D increase in economic growth

(AAA ID 3.4)

Question 3.5

You have just completed a SWOT analysis for Gems Ltd (Gems).

Which **one** of the following is **not** a threat?

A Diamonds are the only product line of Gems.
B The introduction of new legislation restricting the sale of diamonds.
C The introduction of a new cheap synthetic diamond by one of Gems's competitors.
D Fluctuations in the foreign exchange rate for the Australian dollar when diamonds are sold on the world market in US dollars.

(AAA ID 3.5)

Question 3.6

As the auditor of Lofty Ltd., you have just completed an analysis of the company's balanced scorecard. You note an increase in the volume of customer complaints.

This is likely to indicate an increase in the risk of

A overstatement of sales.
B overstatement of inventory.
C understatement of purchases.
D overstatement of warranty expenses.

(AAA ID 3.6)

Question 3.7

Which of the following need to be documented by the auditor?

Select which **three** options are correct.

A the audit plan
B the overall audit strategy
C changes to the makeup of the audit team
D the reasons for significant changes to the original detailed audit plan

(AAA ID 3.7)

Question 3.8

Your client has a December year-end, with December and January being very busy months. The client has decided to make a public offering next year.

In the audit of sales revenue the auditor would be **most concerned** with

A cut-off.
B accuracy.
C disclosure.
D completeness.

(AAA ID 3.8)

Question 3.9

In the audit of accounts payable the auditor is normally **most concerned** with

A existence.
B completeness.
C rights and obligations.
D valuation and allocation.

(AAA ID 3.9)

Question 3.10

Your audit client has a debt covenant that requires a 2:1 interest cover ratio.

With respect to interest expense, the auditor would be **most interested** in

A cut-off.
B accuracy.
C occurrence.
D completeness.

(AAA ID 3.10)

Question 3.11

Your client is in a highly competitive industry with the majority of the competition coming from overseas. Its products have a relatively short life cycle and product development is continuous in order to keep up with competitors.

For the inventory account, the assertion upon which most audit effort should be concentrated is

A existence.
B completeness.
C rights and obligations.
D valuation and allocation.

(AAA ID 3.11)

Question 3.12

Your client is a manufacturer of outdoor furniture. Theft of inventory has been an ongoing problem.

The key audit risk to be addressed at year end in relation to inventory is

A existence.
B valuation.
C completeness.
D rights and obligations.

(AAA ID 3.12)

Question 3.13

Which **one** of the following is **not** one of the categories of assertions identified in ISA 315 (revised) *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*?

A accounting policies
B presentation and disclosure
C account balances at the period end
D classes of transactions and events for the period under audit

(AAA ID 3.13)

Question 3.14

Which **one** of the following is **not** a general computer control?

A The use of systems software logs to monitor attempts to access the operating system.
B The procedures for documenting, reviewing, testing and approving systems or programs and changes.
C The organisational structure and operation of the IT activity including controls over access to the equipment and data files.
D Procedures to assure only authorised personnel receive the output from the weekly update of the accounts receivable masterfile.

(AAA ID 3.14)

Question 3.15

Which **one** of the following terms **best** describes the type of control evidenced by a segregation of duties between computer programmers and computer operators?

A application control
B systems software control
C organisational and management control
D systems development and program maintenance control

(AAA ID 3.15)

Question 3.16

Expo Engineering Ltd is a wholesale distributor of professional equipment and supplies. The company's sales have averaged about $10 million annually for the three-year period 20X2–20X4. The company's total assets at the end of 20X4 amounted to $9 million. You have been appointed as auditor for the year 20X5.

As part of your planning to obtain information about this new client, you have calculated the following ratios for the three-year period 20X2–20X4.

	20X2	20X3	20X4
Quick asset ratio	1.09	0.99	0.88
Current ratio	1.81	1.93	1.97
Inventory turnover	4.72	4.31	3.41
Accounts receivable turnover	8.74	7.70	6.41
Per cent of total debt to total assets	48.00	45.00	42.00
Per cent of long-term debt to total assets	28.00	24.00	21.00
Sales to fixed assets (fixed asset turnover)	1.57	1.68	1.78
Sales as a per cent of 20X2 sales	1.00	1.03	1.05
Gross margin percentage	36.10	34.80	34.70
Net income to sales (%)	7.00	7.00	7.20
Return on shareholders' equity (%)	13.70	13.20	12.80
Return on total assets (%)	7.80	7.80	7.90

The current ratio is increasing while the quick asset ratio is decreasing.

Which **one** of the following factors may explain this apparently divergent trend?

A a decrease in inventory
B an increase in inventory
C a decrease in accounts receivable
D an increase in accounts receivable

(AAA ID 3.16)

Question 3.17

Expo Engineering Ltd is a wholesale distributor of professional equipment and supplies. The company's sales have averaged about $10 million annually for the three-year period 20X2–20X4. The company's total assets at the end of 20X4 amounted to $9 million. You have been appointed as auditor for the year 20X5.

As part of your planning to obtain information about this new client, you have calculated the following ratios for the three-year period 20X2–20X4.

	20X2	**20X3**	**20X4**
Quick asset ratio	1.09	0.99	0.88
Current ratio	1.81	1.93	1.97
Inventory turnover	4.72	4.31	3.41
Accounts receivable turnover	8.74	7.70	6.41
Per cent of total debt to total assets	48.00	45.00	42.00
Per cent of long-term debt to total assets	28.00	24.00	21.00
Sales to fixed assets (fixed asset turnover)	1.57	1.68	1.78
Sales as a per cent of 20X2 sales	1.00	1.03	1.05
Gross margin percentage	36.10	34.80	34.70
Net income to sales (%)	7.00	7.00	7.20
Return on shareholders' equity (%)	13.70	13.20	12.80
Return on total assets (%)	7.80	7.80	7.90

Which **one** of the following conclusions can be drawn regarding the company's use of financial leverage and equity during the 20X2–20X4 period?

A equity has increased
B long-term debt has increased
C total debt has remained constant
D long-term debt has become more expensive

(AAA ID 3.17)

Question 3.18

Expo Engineering Ltd (Expo) is a wholesale distributor of professional equipment and supplies. The company's sales have averaged about $10 million annually for the three-year period 20X2–20X4. The company's total assets at the end of 20X4 amounted to $9 million. You have been appointed as auditor for the year 20X5.

As part of your planning to obtain information about this new client, you have calculated the following ratios for the three-year period 20X2–20X4.

	20X2	20X3	20X4
Quick asset ratio	1.09	0.99	0.88
Current ratio	1.81	1.93	1.97
Inventory turnover	4.72	4.31	3.41
Accounts receivable turnover	8.74	7.70	6.41
Per cent of total debt to total assets	48.00	45.00	42.00
Per cent of long-term debt to total assets	28.00	24.00	21.00
Sales to fixed assets (fixed asset turnover)	1.57	1.68	1.78
Sales as a per cent of 20X2 sales	1.00	1.03	1.05
Gross margin percentage	36.10	34.80	34.70
Net income to sales (%)	7.00	7.00	7.20
Return on shareholders' equity (%)	13.70	13.20	12.80
Return on total assets (%)	7.80	7.80	7.90

Which **one** of the following conclusions can be drawn regarding the company's net investment in plant and equipment?

A Plant and equipment has increased.
B Plant and equipment has decreased.
C Plant and equipment has remained constant.
D The movement in plant and equipment cannot be determined.

(AAA ID 3.18)

Question 3.19

What technique should the auditor use in assessing the risk of material misstatement?

A The auditor should obtain written representation from the entity's management.
B The auditor should relate the identified risks to what can go wrong at the assertion level.
C The auditor should consider the implications of the identified risks for the auditor's report.
D The auditor should familiarise themselves with the client's industry and current market conditions.

(AAA ID 3.19)

Question 3.20

Which **one** of the following evidence-collecting procedures is likely to be the **most effective** in testing the completeness of accounts receivable?

A Select a sample of subsequent cash receipts and verify that related sales were cut off properly.
B Select a sample of customers and verify that the year-end balance does not exceed the customer's credit limit.
C Recalculate the client's ageing of accounts receivable and trace a sample of the outstanding invoices to the ageing.
D Select a sample of shipping documents around the year-end and ensure that all shipments prior to the year-end were invoiced and recorded in the accounts receivable sub-ledger.

(AAA ID 3.20)

Question 3.21

Which **one** of the following matters would **not** be considered by the auditor in establishing the overall audit strategy?

A industry-specific reporting requirements
B the legal and regulatory framework applicable to the entity
C testing of key controls which the auditor intends to rely upon
D audit areas where there is higher risk of material misstatement

(AAA ID 3.21)

Module 4

Question 4.1

The auditor has identified the existence of inventory as a major risk. In designing appropriate substantive tests related to existence, the auditor has decided to place reliance on two control activities: the client's methods of counting inventory at the annual stocktake and the existence of a gatekeeper at the exit to the premises.

Select which **two** options are correct.

A Procedures for the identification and recording of obsolete inventory are more important for assessing the existence of inventory than procedures related to inventory under the custody and control of a third party.
B Carrying out tests of control at the annual inventory stocktake is likely to provide information on which greater reliance can be placed than controls over the operation of the gatekeeper.
C Tests of details to ensure the inventory cost-flow assumption, such as FIFO, are being appropriately applied are meeting the valuation assertion rather than the existence assertion.
D Inventory cut-off is assessed by examining large sales transactions to ensure that inventory is reduced (credited) when the sale is recorded.

(AAA ID 4.1)

Question 4.2

Which **one** of the following would **not** be considered a substantive audit procedure?

A Obtaining a letter from the bank confirming an account balance.
B Using audit software to identify all accounts receivable over 90 days outstanding.
C Taking a sample of purchase orders and checking that all orders over $10 000 are authorised by a purchasing officer.
D Multiplying the number of employees on each pay scale by the yearly pay rate to determine an estimate of payroll expense.

(AAA ID 4.2)

Question 4.3

You are auditing fundraising revenue for the not-for-profit organisation Helpers Ltd (Helpers). The major fundraising activity of Helpers is a door-to-door collection with authorised collectors. Donations are collected by the authorised collectors, placed in a sealed collection box, and a pre-numbered tax receipt is expected to be issued for each donation. You have determined that completeness of fundraising revenue is the major audit risk.

Which **one** of the following audit procedures will **not** help address this audit risk?

A Reconcile the total of tax receipts issued with the cash recorded and banked.
B Observe the opening of the collection boxes to ensure that the seals have not been broken.
C Undertake a sequence check of the numbering of tax receipts for any unauthorised or duplicate receipts.
D Ensure that we know the identity of the authorised collectors, and the collection areas they have been assigned.

(AAA ID 4.3)

Question 4.4

Which **one** of the following computer-assisted audit techniques (CAATs) is **not** useful for substantive testing of transactions and balances?

A test data
B utility programs
C specialised audit software
D generalised audit software (GAS)

(AAA ID 4.4)

Question 4.5

The auditor uses generalised audit software (GAS) to audit the inventory masterfile of an audit client. Fields in the inventory masterfile include quantity on hand, quantity purchased this year, quantity sold this year, date of last sale, cost price, recommended selling price, and last sales price.

Which **one** of the following analyses is an exception report that can be produced from the information stored on the client's masterfile to assist the auditor in the valuation and allocation assertion for inventory?

A A report highlighting those inventory items where quantity purchased this year is greater than quantity sold this year.
B A report comparing the masterfile totals of quantity on hand times cost price, with quantity on hand times last selling price.
C A report comparing the masterfile totals of quantity on hand times cost price, with quantity on hand times recommended selling price.
D A report highlighting those items where there is a positive inventory on hand at year-end, but last sale date is greater than three months before year-end.

(AAA ID 4.5)

Question 4.6

Which **one** of the following methods is **most likely** to be considered inappropriate for selecting a sample of inventory for physical inspection?

A The auditor selects the first 20 items from page 3 of the inventory listing.
B The auditor selects every 100th item from the 2000 items on the inventory listing.
C The auditor uses random number tables to select 20 items from the inventory listing.
D Without any reference to random number tables, the auditor, without any conscious bias, selects two items from each page of the 10-page inventory listing.

(AAA ID 4.6)

Question 4.7

An underlying feature of random-based selection of items is that each

A item must be systematically selected using replacement.
B item in the accounting population be randomly ordered.
C item in the accounting population should have an opportunity to be selected.
D stratum of the accounting population be given equal representation in the sample.

(AAA ID 4.7)

Question 4.8

One reason why the independent auditor performs substantive analytical procedures on the client's gross margin is to

A identify unusual transactions of a material nature.
B identify non-compliance with prescribed control procedures.
C identify deficiencies of a material nature in the internal control procedures.
D reduce the level of testing of details that would need to be undertaken on associated accounts.

(AAA ID 4.8)

Question 4.9

In which **one** of the following audit procedures are 'existence' and 'valuation and allocation' of accounts receivable the major assertions of interest?

A positive external confirmation of accounts receivable
B negative external confirmation of accounts receivable
C agreeing amounts listed on the aged accounts receivable trial balance to subsequent receipts
D vouching transactions back to supporting documentation and ensuring that the dollar value is correctly recorded

(AAA ID 4.9)

Question 4.10

To obtain direct evidence that online access controls are properly functioning, an auditor is **most likely** to

A vouch a random sample of processed transactions to assure proper authorisation.
B enter invalid identification numbers or passwords to ascertain whether the system rejects them.
C create checkpoints at periodic intervals after live data processing to test for unauthorised use of the system.
D examine the transaction log to discover whether any transactions were lost or entered twice because of a system malfunction.

(AAA ID 4.10)

Question 4.11

You are considering using the work of the internal auditors of ABC Ltd.

Which **one** of the following facts identified in the review of the internal audit function will give you confidence that the internal auditor is technically competent?

A The head of internal audit has a direct reporting line to the audit committee.
B The head of internal audit is free from the influences of operational management.
C The head of internal audit is a professionally trained auditor and a member of the Institute of Internal Auditors.
D The internal audit function regularly examines controls over all the significant accounting operations that affect the financial statements.

(AAA ID 4.11)

Question 4.12

A primary advantage of using generalised audit software (GAS) in auditing the accounts receivable masterfile of a client is that the auditor may

A reduce the level of required tests of controls associated with sales and cash receipts.
B substantiate the accuracy of sales and receipts transactions data through self-checking digits and hash totals.
C consider increasing the use of substantive tests of sales and receipts transactions in place of substantive analytical procedures.
D access information stored on the accounts receivable masterfile without a complete understanding of the client's hardware and software features.

(AAA ID 4.12)

Question 4.13

Simon Ltd has numerous customers. Each customer record on the accounts receivable masterfile contains the customer name, address, credit limit and account balance. The auditor wishes to identify whether or not credit limits are exceeded at the end of the year.

The **best** procedure for the auditor to follow is to

A request a printout of all account balances so they can be manually checked against the credit limits.
B request a printout of a sample of account balances so they can be individually checked against the credit limits.
C develop test data that would cause some account balances to exceed the credit limit and determine if the system properly detects such situations.
D use audit software to compare credit limits with account balances and print out the details of any account with a balance exceeding its credit limit.

(AAA ID 4.13)

Question 4.14

Which **one** of the following computer-assisted audit techniques (CAATs) allows fictitious and real transactions to be processed together without the knowledge of client operating personnel?

A parallel simulation
B program code review
C integrated test facility (ITF)
D generalised audit software (GAS)

(AAA ID 4.14)

Question 4.15

Computer systems are typically supported by a variety of utility software packages that may be useful to an auditor because they

A may enable the auditor to make changes to the client's data files.
B may be significant components of a client's application programs.
C are reliable packages, generally supporting a specific computer system.
D are very versatile programs that can be used on hardware of many manufacturers.

(AAA ID 4.15)

Question 4.16

For which **one** of the following material events occurring subsequent to the 30 June 20X9 balance date would the auditor require disclosure in the subsequent events note to the financial statements? The auditor's report is to be completed and signed on 26 August 20X9.

A The undertaking of negotiations to secure the services of the chief financial officer of your major competitor.
B Adjustment for inventory that was purchased before year-end but had sold after year-end for an amount substantially below its cost price.
C The acquisition of a subsidiary on 23 July 20X9 that was expected to increase sales for the consolidated entity by 25 per cent in the next financial year. Negotiations had begun on 8 June 20X9.
D The refusal to adjust inventory for an obsolescence write-down identified by the auditor. This did not result in a modified auditor's opinion because the auditor and client agreed that the amount was immaterial to the financial statements.

(AAA ID 4.16)

Question 4.17

A letter addressed by management to auditors and that confirms in writing any statements made by management to the auditors during the course of an audit is commonly referred to as

A a management letter.
B an engagement letter.
C an audit representation letter.
D a management representation letter.

(AAA ID 4.17)

Question 4.18

Which **one** of the following statements is correct in relation to evidence-gathering in an e-commerce environment?

A It is not necessary to evaluate controls in an e-commerce environment.
B The auditor is not likely to use computer-assisted audit techniques (CAATs) in an e-commerce environment.
C The auditor will have to undertake increased substantive testing because of the lack of controls in an e-commerce environment.
D The need for computer-assisted audit techniques (CAATs) is likely to increase in line with the level of integration of e-commerce systems.

(AAA ID 4.18)

Question 4.19

An auditor is assessing the risk of material misstatement for two small companies. For Company X, the auditor assesses a greater incentive to understate reported profit due to the financial statements being used predominantly for tax purposes; for Company Y, the auditor assesses that there is an incentive to overstate reported profit as the financial statements are required to seek extra financing from the bank.

Which **one** of the following is correct in considering the response to assessed risk for debtors?

A The auditor is more likely to extensively use debtors' confirmation techniques for Company X compared with Company Y.
B The auditor is less likely to extensively use debtors' confirmation techniques for Company X compared with Company Y.
C The auditor is equally likely to extensively use debtors' confirmation techniques for Company X compared with Company Y.
D The auditor will not be likely to use debtors' confirmation techniques for either Company X or Company Y as this substantive technique is not suitable for small company audits.

(AAA ID 4.19)

Question 4.20

The auditor has concluded that a significant going concern uncertainty exists at Client Co.

Which **one** of the following procedures is **least likely** to provide useful evidence as to the ability of Client Co. to continue as a going concern?

A analysing and discussing cash flow and profit forecasts with management
B examining related party transactions to identify potential sources of finance
C reviewing the terms of loan agreements and determining whether any have been breached
D reviewing events after period end to identify those that either mitigate or otherwise affect the entity's ability to continue as a going concern

(AAA ID 4.20)

Question 4.21

In the audit of the accounts receivable balance, as the acceptable level of detection risk decreases, an auditor may change the

A assessed level of inherent risk for accounts receivable to high rather than medium.
B timing of tests of controls on related sales transactions by performing them at several dates rather than at one time.
C nature of substantive tests from a negative external confirmation procedure to a positive external confirmation procedure.
D timing at which positive external confirmation procedures are undertaken by performing them at the month before year-end rather than at year-end.

(AAA ID 4.21)

Module 5

Question 5.1

A refusal by the directors to furnish a written representation stating that they have fulfilled their responsibility for the preparation of the financial statements in accordance with the applicable financial reporting framework constitutes

A a situation sufficient to preclude an unmodified opinion.
B a situation in which the auditor must seek alternative sources of evidence.
C prima facie evidence that the financial statements are not presented fairly.
D a situation in which the auditor can still issue an unmodified opinion if the risks of material misstatement at the assertion level have been reduced to an acceptable level.

(AAA ID 5.1)

Question 5.2

An auditor is unable to determine the amounts associated with certain illegal acts committed by a client that appear material in their nature and amount. In these circumstances, the auditor would **most likely** issue

A an adverse opinion.
B a disclaimer of opinion.
C either a qualified opinion or an adverse opinion.
D either a qualified opinion or a disclaimer of opinion.

(AAA ID 5.2)

Question 5.3

The auditor has concluded that the management of XYZ Ltd has inappropriately applied the requirements of IAS 17 *Leases*. This departure from IAS 17 has a material financial effect on the financial statements of the company.

What type of audit opinion should be issued?

A a qualified opinion
B an adverse opinion
C an unmodified opinion
D a disclaimer of opinion

(AAA ID 5.3)

Question 5.4

Your audit client has not written inventory down to net realisable value in accordance with IAS 2 *Inventories*. The write-down would reduce current assets by 15 per cent.

What type of audit opinion should you issue?

A a qualified opinion
B an adverse opinion
C a disclosure as a key audit matter
D an unmodified opinion with an Emphasis of Matter paragraph

(AAA ID 5.4)

Question 5.5

The directors of your client (a company listed on the stock exchange) refuse to disclose directors' remuneration of $500 000 on the basis that it is not quantitatively material. Net profit after tax is $20 million and net assets total $50 million. What is the appropriate audit opinion?

A a qualified opinion
B an adverse opinion
C a disclaimer of opinion
D an unmodified opinion with an Emphasis of Matter paragraph

(AAA ID 5.5)

Question 5.6

A client is facing significant litigation as a result of a claim that it dumped oil in the ocean. This is a significant issue, which the auditor agrees is adequately disclosed in the notes to the financial statements. The appropriate audit opinion is

A a qualified opinion
B an adverse opinion
C a disclaimer of opinion
D an unmodified opinion with an Emphasis of Matter paragraph

(AAA ID 5.6)

Question 5.7

Which **one** of the following will **most likely** be disclosed by the auditor as a key audit matter?

A the risk of fluctuations in the market price of gold for a gold mining company
B a complex judgment about the most appropriate basis for revenue recognition
C a disagreement with management about the disclosure of related party transactions
D a concern that the entity will fail to meet its debt obligations in the next 12 months that is not adequately disclosed

(AAA ID 5.22)

Question 5.8

An auditor has been unable to obtain audited financial statements for the entity's major foreign subsidiary due to civil unrest in that country. This may have a pervasive effect on the consolidated financial statements. The appropriate audit opinion for the consolidated financial statements is

A a qualified opinion.
B an adverse opinion.
C a disclaimer of opinion.
D an unmodified opinion with an Emphasis of Matter paragraph.

(AAA ID 5.8)

Question 5.9

An entity operates in a highly regulated industry with special legislated reporting requirements. It has complied with these reporting requirements. However, this has resulted in the entity not complying with the requirements of some International Financial Reporting Standards. The notes to the financial statements claim that the financial statements have been prepared in accordance with both the special legislated reporting requirements and International Financial Reporting Standards.

What type of audit opinion should be issued?

A a qualified opinion
B an adverse opinion
C both an unmodified and a qualified opinion
D an unmodified opinion with an Emphasis of Matter paragraph

(AAA ID 5.9)

Question 5.10

An entity is being sued for substantial damages for producing a faulty product. However, while the result of the litigation will not be known for some time, the entity believes that the claim is unjustified and that it will be successful in defending the action. As a result, it has not included any reference to the lawsuit in the financial statements. The audit firm's independent legal advice suggests that the outcome of the case is unclear.

What type of audit opinion should be issued?

A a qualified opinion
B a disclaimer of opinion
C an unmodified opinion with an Other Matter paragraph
D an unmodified opinion with an Emphasis of Matter paragraph

(AAA ID 5.10)

Question 5.11

How are the governing body's responsibility and the auditor's responsibility represented in the auditor's report?

	Governing body's responsibility	**Auditor's responsibility**
A	explicitly	explicitly
B	implicitly	implicitly
C	implicitly	explicitly
D	explicitly	implicitly

(AAA ID 5.11)

Question 5.12

Under which **one** of the following circumstances would a disclaimer of opinion **not** be an appropriate option?

A The auditor is unable to verify the account balances of a major subsidiary.
B The chief executive officer is unwilling to sign the management representation letter.
C The auditor is unable to determine the amounts associated with an employee fraud scheme.
D Management does not provide reasonable justification for a change in accounting principles.

(AAA ID 5.12)

Question 5.13

Which **one** of the following statements is correct in relation to concise financial reports undertaken in accordance with the *Corporations Act 2001* (Cwlth) in Australia?

A It is not possible to issue an Emphasis of Matter paragraph on a concise financial report.
B The audit of a concise financial report should be treated as a separate engagement from the audit of the full financial statements.
C The audit opinion paragraph for a concise financial report is worded the same as the audit opinion paragraph for an audit of the financial statements.
D It is not necessary for the auditor to undertake any additional audit procedures for the audit of a concise financial report beyond those required to express an opinion on the full financial statements.

(AAA ID 5.13)

Question 5.14

Which **one** of the following wordings would you expect to see in an auditor's opinion on a reasonable assurance engagement undertaken to determine compliance with a compliance framework?

A The financial statements give a true and fair view of … in accordance with the applicable financial reporting framework.
B The financial statements are presented fairly, in all material respects, in accordance with the applicable financial reporting framework.
C The financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.
D Nothing has come to my attention to suggest that the financial statements are not prepared in accordance with the applicable financial reporting framework.

(AAA ID 5.14)

Question 5.15

You are undertaking a review of interim financial information for ABC Ltd (ABC), for which you are also the independent auditor.

Which **one** of the following procedures would **not** normally be part of the review?

A comparison of draft financial statements with budget
B testing of computer controls over major transactions cycles
C inquiry of management's identification of events that require disclosure or adjustment
D discussions with the governing body as to whether it has changed the way it assesses ABC's ability to continue as a going concern

(AAA ID 5.15)

Question 5.16

For which of these engagements is assurance **not** provided?

Select which **two** options are correct.

A compilation engagement
B agreed-upon procedures engagement
C the audit of prospective financial information based on hypothetical assumptions
D review of financial information where the assurance provider is not the auditor of the entity

(AAA ID 5.16)

Question 5.17

You are issuing a report for an agreed-upon procedures engagement related to a report prepared by management about an entity's compliance with environmental requirements.

Your report should contain which **one** of the following?

A An opinion about whether management's assertion on environmental compliance is fairly stated.
B A statement that the distribution of the report will be restricted to specifically identified parties.
C A statement that the procedures undertaken are your responsibility and are sufficient for the purposes of the engagement.
D A negative assurance statement that there is no evidence that management did not comply with environmental requirements.

(AAA ID 5.17)

Question 5.18

The auditor has satisfied themselves that the client's financial statements are not materially misstated. However, the company is the defendant in a major lawsuit involving the safety of its most important product. At present, management and the firm's solicitors are unable to estimate the liability that may eventuate. The lawsuit is properly disclosed in the notes to the financial statements.

What type of opinion should be issued?

A The auditor should issue an unmodified opinion.
B The uncertainty is extreme and the auditor should issue a disclaimer of opinion.
C The uncertainty represents a situation where the auditor is unable to obtain sufficient appropriate audit evidence and the auditor should issue a qualified opinion explaining this limitation.
D The auditor should issue an unmodified opinion with an Emphasis of Matter paragraph regarding the uncertainty in the auditor's report.

(AAA ID 5.18)

Question 5.19

The auditor has determined that there is a significant going concern uncertainty at Client Co. due to the requirement to refinance the company's debt. Discussions with management and the auditor's evaluation of management's plans for future actions in relation to its going concern assessment have revealed that plans to raise new equity finance are realistic and likely to deal with the problem.

Is it appropriate for Client Co. to prepare its financial statements on a going concern basis?

A No, Client Co. cannot prepare its financial statements on a going concern basis because a significant uncertainty exists.
B Yes, Client Co. can prepare its financial statements on a going concern basis. However, the auditor is required to express a qualified opinion.
C Yes, Client Co. can prepare its financial statements on a going concern basis. No additional disclosure is necessary in the financial statements or the auditor's report.
D Yes, Client Co. can prepare its financial statements on a going concern basis. However, disclosure of both the nature of the uncertainty and management's plans is required.

(AAA ID 5.19)

Question 5.20

The auditor has determined that there is a material going concern uncertainty at Client Co. due to a current loss, negative cash flows and poor economic circumstances. Inquiries of management have not revealed any practical plans to deal with the problem.

Is it appropriate for Client Co. to prepare its financial statements on a going concern basis?

A No, Client Co. cannot prepare its financial statements on a going concern basis because a material uncertainty exists.
B Yes, Client Co. can prepare its financial statements on a going concern basis. No additional disclosure is necessary in the financial statements or the auditor's report.
C Yes, Client Co. can prepare its financial statements on a going concern basis. However, disclosure of both the nature of the uncertainty and management's plans in the financial statements is required. No additional disclosure is necessary in the auditor's report.
D Yes, Client Co. can prepare its financial statements on a going concern basis. However, disclosure of both the nature of the uncertainty and management's plans is required. Additionally, the auditor must include a Material Uncertainty Related to Going Concern paragraph in the auditor's report.

(AAA ID 5.20)

Question 5.21

The auditor has determined that there is a material going concern uncertainty at Client Co. due to a current loss, negative cash flows and poor economic circumstances. Management insists that the going concern basis is appropriate for the preparation of the financial statements because its budget shows the company returning to profitability and positive cash flows in the subsequent year. The auditor questions the assumptions used by management in the preparation of the budget, but management has refused the auditor's request to recast the budget.

What course of action must the auditor follow?

A The auditor must provide an adverse opinion because the going concern assumption is not appropriate.
B The auditor must provide a qualified opinion and include an Other Matter paragraph in the auditor's report.
C The auditor can issue an unqualified auditor's opinion but must include a Material Uncertainty Related to Going Concern paragraph explaining the circumstances in the auditor's report.
D The auditor must provide a qualified opinion but should not include an Other Matter paragraph in the auditor's report.

(AAA ID 5.21)

Module 6

Question 6.1

Which **one** of the following is an example of improved effectiveness?

A rationalisation of facilities
B greater outputs from the same inputs
C introduction of charges where none previously existed
D an increase in the percentage of streets rated as having a satisfactory level of cleanliness and appearance in terms of a city's street maintenance program

(AAA ID 6.1)

Question 6.2

In a performance audit, which of the following would the auditor be concerned with?

Select which **two** options are correct.

A whether the entity has achieved its stated objectives
B whether the entity has followed relevant requirements applicable to it
C whether the entity has operated in the most economic and efficient manner
D whether the financial statements are fairly presented in accordance with the identified financial reporting framework

(AAA ID 6.2)

Question 6.3

Which **one** of the following is an example of an improvement in efficiency?

A Local councils reduce landfill requirements through provision of recycling centres.
B The state government initiates a tender process for constructing a new motorway.
C The government completes a major tunnel before its scheduled date of completion.
D More building applications are processed by a council in a month without an increase in the level of staffing

(AAA ID 6.3)

Question 6.4

Which **one** of the following is **not** a performance output indicator?

A the number of police per 50 000 people
B the number of support visits by family welfare officers
C the kilometres of electricity cables provided by an electricity authority
D the number of planning applications processed by a planning authority

(AAA ID 6.4)

Question 6.5

Which of the following statements are correct?

Select which **three** options are correct.

It is important to establish performance audit criteria because they

A indicate the scope of the performance audit.
B are a basis for communication with management.
C are a basis for developing audit programs and questionnaires.
D document the efficiency targets for assessment by the performance auditor.

(AAA ID 6.5)

Question 6.6

A performance auditor identifies performance inconsistent with the established audit criteria.

What problem arises if the relationship between cause and effect is **not** determined?

A The audit cannot proceed.
B The criteria cannot be established.
C The impact on the financial statements cannot be determined.
D A recommendation cannot be made to address the cause of the problem.

(AAA ID 6.6)

Question 6.7

In reporting audit findings, why does an auditor evaluate evidence against criteria?

A to determine risk
B to develop the audit scope
C to ensure reasonable criteria have been established
D to develop conclusions relevant to the audit objectives

(AAA ID 6.7)

Question 6.8

Which **one** of the following can be considered as an example of an effectiveness performance indicator?

A reduction in the cost of outpatient care in a public hospital
B reduction in the number of caseloads for social workers at a welfare centre
C increase in the number of patients treated daily in a hospital emergency ward
D reduction in the number of flu cases occurring after a flu vaccination program

(AAA ID 6.8)

Question 6.9

Which **one** of the following is an example of 'improved economy'?

A shorter waiting lists
B better targeted incentives
C increasing outputs with the same inputs
D reducing costs through better contracting

(AAA ID 6.9)

Question 6.10

Which **one** of the following alternatives defines the scope of a performance audit?

A probity of personnel
B merits of government policy
C compliance with relevant laws and regulations
D economy, efficiency and effectiveness of the management of resources

(AAA ID 6.10)

Question 6.11

A public sector performance audit differs in many significant ways from an audit of historical financial statements for a listed company.

Which **one** of the following is **not** one of these significant differences?

A the assurance practitioner
B the subject matter information
C the criteria used by the assurance provider
D the collection of sufficient and appropriate evidence

(AAA ID 6.11)

Question 6.12

One of the main differences between a performance audit and an audit of historical financial statements is the nature of the auditor's report. Which of the following statements identify differences in the reports?

Select which **three** options are significant differences.

A In a performance audit, the auditor will normally provide a 'preliminary study report'.
B In a performance engagement, the auditor's report provides information on the cause of any deviation from the criteria.
C The auditor's report on a financial statement audit includes an 'opinion', while in a performance audit, the report includes a 'conclusion'.
D In a performance audit, the auditor's report does not describe the responsibilities of management and the auditor as these are established by regulation.

(AAA ID 6.12)

Question 6.13

Which **one** of the following statements **best** describes the role of the Auditor-General in Australia?

A The Auditor-General is the main external auditor of the public sector.
B The Auditor-General provides assurance on the financial reports of government entities.
C The Auditor-General provides assurance services to the Australian Department of Defence.
D The Auditor-General provides recommendations to improve the management practices of government entities.

(AAA ID 6.13

Question 6.14

One of the objectives of performance auditing is to assist managers by identifying and promoting better management practices.

Which **one** of the following activities would be **most useful** in fulfilling this objective?

A Provide assurance that management's reports are reliable.
B When outcomes are inconsistent with audit criteria, seek information as to the effect of the problem.
C When outcomes are inconsistent with audit criteria, seek information as to the cause of the problem.
D Provide assurance that management's internal controls are well designed and functioning as intended.

(AAA ID 6.14)

Question 6.15

Which **one** of the following statements **best** describes 'effectiveness'?

A the relationship between outputs and outcomes of a program
B the relationship between the inputs and outputs of a program
C the relationship between resources used and outcomes of a program
D the relationship between resources used and the inputs of a program

(AAA ID 6.15)

Question 6.16

A performance auditor collects financial information from all of the hospitals in the state of Victoria. The auditor then analyses the data collected by calculating and comparing the ratio of patients treated to cost of the doctors and nurses at each hospital (treatments per $).

Which **one** of the following **best** describes this analysis?

A The analysis provides a measure of the economy of each hospital.
B The analysis provides a measure of the efficiency of each hospital.
C The analysis provides a measure of the effectiveness of each hospital.
D The analysis provides a measure of the value for money provided by each hospital.

(AAA ID 6.16)

Module 7

Question 7.1

Which of the following areas of competencies will aid the assurance provider in their provision of other assurance services?

Select which **three** options are correct.

A analytical skills
B business knowledge and advisory skills
C International Financial Reporting Standards
D measurement theory and performance measures

(AAA ID 7.13)

Question 7.2

One of the attributes of a good performance measure is that it is 'verifiable'.

Verifiable means the measure

A should have a clear, unambiguous definition so that data can be collected consistently.
B should be capable of being compared with past data or data from similar organisations.
C is capable of being influenced by actions that can be attributable to the organisation.
D can be validated and reproduced so that an independent assessment should result in similar conclusions.

(AAA ID 7.2)

Question 7.3

Assurance standards classify the subject matter of an assurance engagement as data, systems and processes, or behaviour. Which of the following subject matters would be classified under 'behaviour'?

Select which **two** options are correct.

A internal control
B corporate governance
C performance indicators
D human resource policies

(AAA ID 7.3)

Question 7.4

Which of the following may form part of the internal audit?

Select which **three** options are correct.

A testing of internal controls
B examination of supporting documents
C providing assurance to shareholders about the financial statements
D field surveys to familiarise the auditor with systems and known problems

(AAA ID 7.4)

Question 7.5

Subject matter for an assurance engagement can be classified as data, systems and processes, or behaviour.

Which **one** of the following is an example of data?

A performance indicators
B human resource policies
C compliance with regulations
D controls over carbon emissions

(AAA ID 7.5)

Question 7.6

In the case of projections, which of the following warnings need to be given to users?

Select which **two** options are correct.

A Projections should not be used for purposes other than those described.
B Management's hypothetical assumptions are reasonable, but future events cannot be predicted with certainty.
C Projections are prepared on the basis of assumptions about future events that management expects will take place.
D Even if events anticipated under hypothetical assumptions occur, actual results are still likely to differ from projections, as other anticipated events often do not occur.

(AAA ID 7.6)

Question 7.7

Which of the following roles do internal auditors take with respect to fraud prevention and detection?

Select which **two** options are correct.

A investigate incidents of potential fraud
B assess adequacy of controls related to fraud prevention
C develop and operate risk identification and management systems
D design internal controls to prevent and detect fraud and be responsible for their operation

(AAA ID 7.7)

Question 7.8

Which of the following would be considered suitable criteria for an internal control assurance engagement?

Select which **two** options are correct.

A Global Reporting Initiative G4 Reporting standards
B criteria developed by users of a specific purpose report
C Internal Control—Integrated Framework (COSO 2013)
D criteria developed by the assurance provider that are available to the intended user

(AAA ID 7.8)

Question 7.9

Which of the following activities related to internal auditing are the responsibility of the Chief Audit Executive, rather than the board?

Select which **two** options are correct.

A approve the risk based internal audit plan
B evaluate the potential for occurrence of fraud
C confirm the independence of the internal audit activity
D develop and control a quality assurance program for internal audit

(AAA ID 7.9)

Question 7.10

ISAE 3400 *The Examination of Prospective Financial Information* states that prospective financial information can be provided in the form of a forecast or projection.

What is the difference between a forecast and a projection?

A There is no difference between a forecast and a projection.
B While a forecast is based on reasonable expectations, a projection is based on hypothetical events that may not be expected to take place.
C While a projection is based on reasonable expectations, a forecast is based on hypothetical events that may not be expected to take place.
D Both forecasts and projections are based on reasonable expectations, but forecasts are mainly subjective while projections are derived from quantitative analysis.

(AAA ID 7.10)

Question 7.11

A company plans to issue a prospectus in order to raise finance for the acquisition of a competitor. The prospectus will include pro forma financial information.

Which **one** of the following statements **best** describes appropriate pro forma financial information?

A There is no specific requirement regarding either the timeframe or the content of pro forma financial information.
B Prospective financial statements for the company and the competitor will be combined to illustrate the future effect of the acquisition.
C The company will provide a forecast that illustrates to the user the expected effect of the transaction for the subsequent five-year period.
D Past financial statements for the company and the competitor will be combined to illustrate the effect of the acquisition, as if it had been made in the prior year.

(AAA ID 7.11)

Question 7.12

An assurance provider has been asked to provide assurance on a company's sustainability report.

Which **one** of the following would provide suitable criteria for this engagement?

A *Australian Water Accounting Standard 1*
B the International Standards on Auditing (ISA)
C the International Financial Reporting Standards (IFRS)
D the *Global Reporting Initiative Sustainability Reporting Guidelines*

(AAA ID 7.12)

Solutions

Module 1

Question 1.1

Correct answer: D

The correct answer is Option D. It is the best description of assurance services because it makes reference to the independence of the assurance provider and the objective of improving the quality of the information that is the subject matter of the assurance service. It also makes reference to the users: the decision-makers who intend to rely on the information.

Options A and B are incorrect because they are not assurance services—they are classified as related services: Option A is a compilation of financial information, and Option B is a consulting engagement.

Option C is incorrect because the statement refers to the objective of a financial statement audit. It does not describe assurance services, and a financial statement audit is only a subset or type of assurance service.

You can review this topic area in Module 1 in the section titled 'Elements of an assurance engagement'. Related services are introduced in Module 1 'Structure and hierarchy of IAASB pronouncements'. The distinction between financial statement audits and assurance services is contained in the introduction to the module.

Question 1.2

Correct answer: D

The correct answer is Option D because the *International Framework for Assurance Engagements*, para. 11, refers to a reasonable assurance engagement and a limited assurance engagement. Examples include audits (reasonable) and reviews (limited).

Options A, B and C are incorrect because the concepts of absolute, high, low, or appropriate levels of assurance are not consistent with the framework.

You can review this topic area in Module 1 in the section titled 'Reasonable and limited assurance'.

Question 1.3

Correct answer: B

The correct answer is Option B. The responsible party is the management of XYZ as they are responsible for the company (the subject matter) and its functions, including the cash budgeting. See the *International Framework for Assurance Engagements*, Appendix para. 2, for a description of the role of the responsible party.

Option A is incorrect because the shareholders of XYZ are not the responsible party as they have no direct authority over the company.

Options C and D are incorrect because either or both the shareholders and the management of CDE are the intended users of the assurance report.

You can review this topic area in Module 1 in the section titled 'Elements of an assurance engagement'.

Question 1.4

Correct answer: A and C

The correct answer is Option A because where one client provides more than 10–15 per cent of the audit fee, an independence threat is created for the assurance firm because of the significant amount of firm revenue received from that client. Option C is correct because an offer of employment to an auditor with an assurance client is also a self-interest threat due to the potential employment income.

Option B is incorrect because it is a self-review threat, where the member of the assurance team may be reviewing some of their own work.

Option D is incorrect because it is an advocacy threat, with the auditor advocating on behalf of its client.

You can review this topic area in Module 1 in the section titled 'Code of Ethics for Professional Accountants'.

Question 1.5

Correct answer: B

The correct answer is Option B because accountants have to avoid any actions that discredit the profession. Such advertisements have the potential to damage the reputation of other firms and the profession.

The other options are incorrect as they relate to individual characteristics rather than conduct.

Option A is incorrect because it is part of the engagement process and requires auditors to maintain an impartial attitude.

Option C, professional scepticism, is incorrect because this is required when collecting and evaluating evidence.

Option D is incorrect because it is not relevant as it is part of the skills and expertise that the auditor is required to have to undertake an assurance engagement.

You can review this topic area in Module 1 in the section titled 'Code of Ethics for Professional Accountants'.

Question 1.6

Correct answer: A and B

The correct answer is Options A and B because they can impact on objectivity as explained in the study guide. Both clearly may result in economic benefits for the auditor, which are the primary source of self-interest threats.

Option C is incorrect because it is a familiarity threat, not a self-interest threat. Friendship might bias the auditor's professional judgment.

Option D is incorrect because it is a self-review threat rather than a self-interest threat.

You can review this topic area in Module 1 in the section titled 'Code of Ethics for Professional Accountants'.

Question 1.7

Correct answer: B and C

The correct answer is Options B and C. Option B is correct because the auditor must maintain their professional scepticism throughout the entire engagement. Option C is important in that it appropriately focuses professional scepticism on management explanations.

Option A is a common but incorrect view of the meaning of scepticism. To be sceptical means to be unbiased or open-minded in the sense that the auditor has no expectation that an amount or transaction has been recorded either correctly or incorrectly.

Option D is incorrect. As noted in the study guide, it is important to maintain an attitude of professional scepticism, 'notwithstanding the auditor's past experience of the honesty and integrity of the entity's management and those charged with governance' (ISA 240 *The Auditor's Responsibility to Consider Fraud in an Audit of Financial Statements*, para. 12).

You can review this topic area in Module 1 in the section titled 'Elements of an assurance engagement' under 'Evidence'.

Question 1.8

Correct answer: A and B

The correct answer is Options A and B. Option B is correct according to ISRE 2410, para. 20. Option A is also correct as a review gives limited rather than reasonable assurance.

Option C is incorrect. Under ISRE 2410, the auditor of an entity can also carry out a review of the interim financial statements. In practice this is what happens for full-year audits and interim reviews of financial statements.

Option D is incorrect because this is a positive form of expression. For the review engagement, the practitioner expresses a conclusion in a form that conveys whether, based on the procedures performed and evidence obtained, a matter has come to the practitioner's attention to cause the practitioner to believe the subject matter information is materially misstated (commonly referred to as a negative form).

You can review this topic area in Module 1 in the section titled 'Reasonable and limited assurance'.

Question 1.9

Correct answer: A, C and D

The correct answer is Options A, C and D. The auditor's judgment and independence may have been impacted by the financial inducements associated with the new role of CFO.

Regarding Options A and D, the code of ethics makes it clear that employment of auditors, especially those who have recently been engaged in the audit, leads to familiarity and intimidation threats.

> *Employment with an Audit Client*
>
> 290.134 Familiarity or intimidation threats may be created if a director or officer of the audit client, or an employee in a position to exert significant influence over the preparation of the client's accounting records or the financial statements on which the firm will express an opinion, has been a member of the audit team or partner of the firm.

Option C, self-interest, is also a threat because the offer of employment is a financial inducement, and may have biased the judgment of the auditor.

Option B is incorrect because it is not relevant to this scenario. Self-review relates to review of one's own work which would not arise in the CFO's role. The CFO would not review the prior auditor's work.

You can review this topic area in Module 1 in the section titled 'Code of Ethics for Professional Accountants', specifically Case Study 1.1.

Question 1.10

Correct answer: A, B and D

All three normally would be included. This does not differ from any financial statement audit where it would be expected that the auditor would provide a report, the report would be submitted to the governing body (parliament in this case) and significant matters regarding internal controls would be communicated to those charged with governance.

Option C is incorrect because an opinion on economy, efficiency and/or effectiveness is the result of a performance audit. Performance audits may be performed along with a financial audit, but are not part of a financial audit.

You can review this topic area in Module 1 in the section titled 'Public sector perspective'.

Question 1.11

Correct answer: A

The correct answer is Option A because in a direct engagement, the subject matter is 'measured or evaluated' by the auditor. Performance audits are often direct engagements.

Options B, C and D are incorrect because they are all engagements where management provides the subject matter to be assured, thus they are attestation engagements.

You can review this topic area in Module 1 in the section titled 'Attestation and direct engagements'.

Question 1.12

Correct answer: B and C

The correct answer is Options B and C. Option B is correct because COSO (2013) provides an established framework for such engagements. Option C is correct because the *International Framework for Assurance Engagements*, para. A48 says that criteria can be established or specifically developed for the purpose of the engagement by the assurance practitioner.

Option A is incorrect because the international accounting standards are an appropriate framework for financial statement audits, but not for an internal control assurance engagement.

Option D is incorrect. ISA 265, as the title suggests, is concerned with the reporting of the findings of an internal control examination. It does not provide criteria for this examination.

You can review this topic area in Module 1 in the section titled 'Elements of an assurance engagement'. See also Module 7 in the section titled 'Assurance on internal control'.

Question 1.13

Correct answer: C

The correct answer is Option C. The price discount is a personal financial advantage to members of the audit team. This results in a self-interest threat.

The question clearly implies a self-interest threat.

Option A is incorrect because a financial threat is not a category of threat that is identified in the *Code of Ethics for Professional Accountants*.

Option B is incorrect because a self-review threat is not relevant in this case.

Option D is incorrect because an intimidation threat is not relevant in this case.

There is no element of self-review or intimidation indicated in the question.

You can review this topic area in Module 1 in the section titled 'Code of Ethics for Professional Accountants'.

Module 2

Question 2.1

Correct answer: D

The correct answer is Option D. Refer to ISA 200 *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*, para. 17:

> To obtain reasonable assurance, the auditor shall obtain sufficient appropriate audit evidence to reduce audit risk to **an acceptably low level** and thereby enable the auditor to draw reasonable conclusions on which to base the auditor's opinion.

Options A, B and C are incorrect as they are not the language used in ISA 200.

You can review this topic area in Module 2 in the section titled 'Overall objectives of the independent auditor and the conduct of an audit in accordance with international standards on auditing'.

Question 2.2

Correct answer: D

The correct answer is Option D. Option D combines Options A and C. Refer to ISA 200 *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*, para. A32, 'Audit risk is a function of the risks of material misstatement and detection risk.'

Option A is incorrect because it does not refer to detection risk.

Option B is incorrect because control risk refers to the risk that the control system will fail to prevent or to detect and correct an error.

Option C is incorrect because it does not refer to the risk of a material misstatement in the financial statements.

You can review this topic area in Module 2 in the section titled 'Overall objectives of the independent auditor and the conduct of an audit in accordance with international standards on auditing'.

Question 2.3

Correct answer: A and D

The correct answer is Options A and D because they are important controls, so a reduction will impact control risk.

Option B is incorrect because it refers to an increase in inherent risk.

Option C is incorrect because it refers to an increase in detection risk.

Refer to ISA 200 *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*, para. A38, for a discussion of inherent risk, and para. A39 for control risk.

You can review this topic area in Module 2 in the section titled 'Overall objectives of the independent auditor and the conduct of an audit in accordance with international standards on auditing'.

Question 2.4

Correct answer: A

The correct answer is Option A. See ISA 240 *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*, para. 26:

> When identifying and assessing the risks of material misstatement due to fraud, the auditor shall, based on a presumption that there are risks of fraud in revenue recognition, evaluate which types of revenue, revenue transactions or assertions give rise to such risks.

Options B, C and D are incorrect because ISA 240 only refers to the auditor presuming the risk of fraud in revenue recognition.

You can review this topic area in Module 2 in the section titled 'The auditor's responsibility to consider fraud in an audit'.

Question 2.5

Correct answer: A

The correct answer is Option A. The reduction of the sample sizes will increase detection risk, not inherent risk.

Options B, C and D are all incorrect because they increase inherent risk.

Option B increases the risk of errors in inventory valuation and foreign exchange uncertainty.

Option C increases inherent risk because errors are more likely during the introduction of a new system.

Option D provides an incentive for financial statement fraud. Refer to ISA 200 *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*, para. A38:

> Inherent risk is higher for some assertions and related classes of transactions, account balances, and disclosures than for others. For example, it may be higher for complex calculations or for accounts consisting of amounts derived from accounting estimates that are subject to significant estimation uncertainty. External circumstances giving rise to business risks may also influence inherent risk. For example, technological developments might make a particular product obsolete, thereby causing inventory to be more susceptible to overstatement. Factors in the entity and its environment that relate to several or all of the classes of transactions, account balances, or disclosures may also influence the inherent risk related to a specific assertion. Such factors may include, for example, a lack of sufficient working capital to continue operations or a declining industry characterized by a large number of business failures.

You can review this topic area in Module 2 in the section titled 'Overall objectives of the independent auditor and the conduct of an audit in accordance with international standards on auditing'.

Question 2.6

Correct answer: A and B

The correct answer is Options A and B.

Option C is incorrect because it is prohibited by ISA 210 *Agreeing the Terms of Audit Engagements*, para. A31:

> … a change may not be considered reasonable if it appears that the change relates to information that is incorrect, incomplete or otherwise unsatisfactory. An example might be where the auditor is unable to obtain sufficient appropriate audit evidence regarding receivables and the entity asks for the audit engagement to be changed to a review engagement to avoid a qualified opinion or a disclaimer of opinion.

Option D is incorrect for the same reason as Option C. Though the scope restriction is out of the control of management, the assurance provider cannot change the terms of the engagement because of the difficulties of obtaining sufficient appropriate audit evidence.

You can review this topic area in Module 2 in the section titled 'Terms of audit engagements'.

Question 2.7

Correct answer: C

The correct answer is Option C. Matters of governance should be discussed with governing bodies, which would include the board and the audit committee. It is not possible to specify which of these is most appropriate in every case. See ISA 260 *Communication with Those Charged with Governance*, para. 11:

> The auditor shall determine the appropriate person(s) within the entity's governance structure with whom to communicate.

Options A and B are incorrect because ISA 260 notes that 'those charged with governance are distinguished from 'management''.

Option D is incorrect because even if the auditor communicates with the audit committee, the auditor should still communicate with the whole board.

You can review this topic area in Module 2 in the section titled 'Communication of audit matters with those charged with governance'.

Question 2.8

Correct answer: A

The correct answer is Option A. In fact, for financial statement fraud the opposite to Option A is true, as per ISA 240 *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*, para. A15, which suggests that making inquiries of others within the entity may result in information that would not be communicated by management.

Options B, C and D are all correct statements that are outlined in ISA 240 and are therefore incorrect answers to this question.

You can review this topic area in Module 2 in the section titled 'The auditor's responsibility to consider fraud in an audit'.

Question 2.9

Correct answer: C

Option C is correct as per ISA 210, para. A28, because there is an indication that the entity misunderstands the objective and scope of the audit.

Option A is incorrect because an engagement letter is only required when the circumstances of the engagement have changed in a significant way. Many auditors will, however, provide an annual letter as a matter of course.

Option B is incorrect. As a precondition of the audit engagement, management must agree to its responsibility for the internal controls that ensure the financial statements are free from material misstatement. However, management cannot assure the financial statements. This is the auditor's role.

Option D is incorrect because a scope limitation is not an acceptable reason for a change in the terms of the engagement. The auditor would probably complete the audit and provide a qualification.

See ISA 210 *Agreeing the Terms of Audit Engagements*, paras 15, A32–3.

You can review this topic area in Module 2 in the section titled 'Terms of audit engagements'.

Question 2.10

Correct answer: A and D

The correct answer is Options A and D. Detection risk is a function of the nature, timing and extent of audit procedures. Rescheduling the inventory testing to the year end provides a better quality test for inventory, and accordingly reduces detection risk. If detection risk is reduced, audit risk is reduced.

Option B is incorrect because it has no effect on control risk.

Option C is incorrect because it has no effect on control risk.

You can review this topic area in Module 2 in the section titled 'Overall objectives of the independent auditor and the conduct of an audit in accordance with international standards on auditing'.

Question 2.11

Correct answer: C

Option C is correct because the task of the engagement quality control reviewer is to complete a high level review of audit judgments.

Options A and B are incorrect because the engagement quality control reviewer is not involved in the audit at the planning stage. Such involvement would lead to a self-review threat and impair the reviewer's objectivity.

Option D is incorrect because the engagement quality control reviewer does not complete a detailed review of the evidence collected by the audit team. The detailed review is done by senior members of the team.

See ISA 220 *Quality Control for an Audit of Financial Statements*, paras 19–21.

You can review this topic area in Module 2 in the section titled 'Quality control for audits'.

Question 2.12

Correct answer: A, B and D

The correct answer is Options A, B and D because all of the information noted in these options is part of the required documentation. Options A and B are needed to identify the correct document, and Option D shows that the selection method is consistent with the audit plan. Options A, B and D are all included as examples in ISA 320, para. 9.

Option C is incorrect. The auditor may document the fact that they have compared the supplier name on the delivery docket, invoice and purchase order to ensure that the purchase is valid, but the auditor is unlikely to document the specific supplier name.

See ISA 230 *Audit Documentation*, paras 9 and A12.

You can review this topic area in Module 2 in the section titled 'Audit documentation'.

Question 2.13

Correct answer: A, C and D

The correct answer is Options A, C and D because they are all intentional acts that lead to misstatements in the financial statements.

Option B is incorrect because it refers to an unintentional omission; fraud is always intentional—see ISA 240 *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*, paras 11 and A4–5. All other actions are intentional. It should be noted that financial statement fraud relates to both amounts and to disclosure.

You can review this topic area in Module 2 in the section titled 'The auditor's responsibility to consider fraud in an audit'.

Question 2.14

Correct answer: A

The correct answer is Option A. ISA 210 *Agreeing the Terms of Audit Engagements* states:

> **Preconditions for an Audit**
>
> para. 6. In order to establish whether the preconditions for an audit are present, the auditor shall … obtain the agreement of management that it acknowledges and understands its responsibility … for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error …
>
> para. 8. If the preconditions for an audit are not present [the agreement referred to above] … [u]nless required by law or regulation to do so, the auditor shall not accept the proposed audit engagement.

Options B, C and D are incorrect because the auditor cannot accept the engagement as management has failed to acknowledge responsibility for the internal control system.

You can review this topic area in Module 2 in the section titled 'Terms of audit engagements'.

Question 2.15

Correct answer: A and C

Option A is correct because ISAs apply to all audits of all sizes and complexity.

Option C is correct because specific audit procedures may vary considerably depending on the size and complexity of an entity.

Option B is incorrect. While some companies limited by guarantee do not need an audit, if they have an audit it must comply with ISAs. While the ISAs do apply to these audits, some requirements may be irrelevant to small companies. The audit plan provides the link between the requirements of the ISAs and the nature of the company.

Option D is incorrect because the Australian standards impose some additional requirements not found in the ISAs, but in no case do they reduce the requirements of the ISAs.

You can review this topic area in Module 2 in the section titled 'Do ISAs apply to entities of all sizes and complexity?'.

Question 2.16

Correct answer: C

The correct answer is Option C. Fraud is defined as 'an intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage' (ISA 240, para. 11).

Option A is incorrect because fraud is always intentional.

Option B is incorrect because fraud includes fraudulent financial reporting and misappropriation of assets.

Option D is incorrect because fraud can also be perpetrated by third parties.

You can review this topic area in Module 2 in the section titled 'The auditor's responsibility to consider fraud in an audit'.

Question 2.17

Correct answer: B

The correct answer is Option B. This does not necessarily constitute fraud because this is a common way of dealing with large or unusual transactions. Normally, internal controls are designed to manage repetitive and common transactions. Management override of controls is a common way that frauds are perpetrated, however, the auditor must remain alert to such circumstances and examine the business rationale carefully.

Options A, C and D are incorrect because they are identified in ISA 240, para. A3 as how financial statement fraud can be accomplished.

You can review this topic area in Module 2 in the section titled 'The auditor's responsibility to consider fraud in an audit'.

Question 2.18

Correct answer: A

The correct answer is Option A because it is a common type of fraud involving misappropriation of assets (misappropriating the cash used to pay for the goods or services) belonging to an entity.

Options B, C and D are incorrect because they are identified in ISA 240, para. A4, as ways that fraudulent financial reporting, rather than misappropriation of assets, can be accomplished.

You can review this topic area in Module 2 in the section titled 'The auditor's responsibility to consider fraud in an audit'.

Question 2.19

Correct answer: D

The correct answer is Option D because all three aspects of the fraud triangle are present. The chief financial officer (CFO) requires money to pay for his son's medical treatment (incentive); a CFO is commonly able to override the company's internal control system (opportunity); and saving the life of his son is an excellent rationalisation for any behaviour.

All three risk factors are present, so Options A, B and C are all incomplete and therefore incorrect.

You can review this topic area in Module 2 in the section titled 'The auditor's responsibility to consider fraud in an audit'.

Question 2.20

Correct answer: A

The correct answer is Option A because this is not an audit planning procedure, it is a state of mind. In accordance with the Code of Ethics, the auditor should always maintain an attitude of professional scepticism.

Option B is incorrect because when assessing the inherent risk in the audit, the auditor would, for example, ask employees, management and the board about their knowledge of fraudulent activities (ISA 240, para. 17 and 18).

Option C is incorrect because the auditor should vary the audit plan from year to year so that the client cannot predict, and so guard against, the auditor's procedures.

Option D is incorrect because engagement team discussions about fraud risk are mandated by the auditing standard (ISA 240, para. 15).

You can review this topic area in Module 2 in the section titled 'The auditor's responsibility to consider fraud in an audit'.

Question 2.21

Correct answer: C

The correct answer is Option C because while there is clearly a self-interest motive here (incentives), and the CEO has the opportunity to override internal controls to approve the transaction, there is no evidence of rationalisation. This reduces the fraud risk somewhat.

Options A and B are incorrect because incentive and opportunity are both present in the situation (i.e. self-interest, motive and opportunity to approve the transaction as CEO).

Option D is incorrect because the risk is not 'high'. There is no evidence of rationalisation, so the fraud risk is reduced.

You can review this topic area in Module 2 in the section titled 'The auditor's responsibility to consider fraud in an audit'.

Question 2.22

Correct answer: C

The correct answer is Option C. Because fraud is most often concealed, there is little point asking direct questions about fraudulent activity. Additionally, the auditor does not want to jeopardise their relationship with the client by asking embarrassing questions.

Options A, B and D are incorrect as they are all noted in ISA 240, para. 17, as appropriate enquiries of management.

You can review this topic area in Module 2 in the section titled 'The auditor's responsibility to consider fraud in an audit'.

Question 2.23

Correct answer: C

The correct answer is Option C because it might constitute a fraud risk factor, but in itself is not indicative of fraud, and so should not be included in communications with those charged with governance in connection with internal control. The auditor's duty in this case is to collect further evidence relating to inventory to determine whether any misstatements have occurred.

Options A, B and D are incorrect because they are all identified in ISA 265, paras. A12-30, as matters that might be included in the auditor's communications with those charged with governance in connection with fraud and specifically, deficiencies in internal control.

You can review this topic area in Module 2 in the section titled 'Communicating deficiencies in internal control to those charged with governance and management'.

Question 2.24

Correct answer: C

The correct answer is Option C. Because the business will cease to exist in the next 12 months, the going concern assumption is not applicable (ISA 570 (revised), para. 2). Under the going concern assumption, an entity is viewed as continuing in business for the foreseeable future. Financial statements are prepared on a going concern basis, unless management intends either to liquidate the entity or to cease operations, or has no realistic alternative but to do so. If the entity is not a going concern, assets and liabilities are recorded at liquidation values.

Option A is incorrect because this is not the relevant period for assessing the going concern assumption. It must be at least 12 months.

Option B is incorrect because a disclaimer of opinion is not required as the client can prepare the financial statements on a liquidation basis. If the client refuses to do this, then the auditor should consider a qualified or an adverse opinion.

Option D is incorrect because disclosure of the matter is inadequate in this circumstance. When the auditor knows that the business will cease, there is no uncertainty and the basis of accounting must be changed.

You can review this topic area in Module 2 in the section titled 'Going concern'.

Question 2.25

Correct answer: B

The correct answer is Option B. ISA 570 (revised), para. 12, identifies that the auditor's key responsibility with regard to the going concern assumption is to evaluate management's assessment. If management has not made such an assessment, the auditor should request that it do so. As noted in ISA 570 (revised), para. A7, management's assessment of the entity's ability to continue as a going concern is a key part of the auditor's consideration of management's use of the going concern assumption.

Option A is incorrect because the auditor always has a responsibility to consider the going concern assumption, not only when potential problems are identified.

Option C is incorrect because the auditor must request management to make an assessment. If management refuses to do so, the auditor might consider this to be a scope limitation.

Option D is incorrect because it describes an evidence gathering procedure rather than an evaluative procedure.

You can review this topic area in Module 2 in the section titled 'Going concern'.

Question 2.26

Correct answer: A, B and D

The correct answer is Options A, B and D because they are all mentioned in ISA 200 *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*.

Option C is incorrect because it is **not** mentioned in ISA 200 *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*. Refer to ISA 200, paras A45–7.

You can review this topic area in Module 2 in the sections titled 'Overall objectives of the independent auditor and the conduct of an audit in accordance with international standards on auditing', 'Professional scepticism' and 'The auditor's responsibility to consider fraud in an audit'.

Module 3

Question 3.1

Correct answer: C

The correct answer is Option C because an internal audit function may provide some control over risks; however, the existence of internal audit has no bearing on the significance of risks.

Options A, B and D are incorrect because they are important to the significance of risks.

See ISA 315 (revised) *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*, para. 28.

You can review this topic area in Module 3 in the section titled 'Identifying and assessing the risks of material misstatement through understanding the entity and its environment'.

Question 3.2

Correct answer: A, B and C

The correct answer is Options A, B and C. Option A, globalisation, is one of the factors that will affect business risk, potentially at both the industry and economic levels. Options B and C are related to business risk. Corporate objectives and strategies (Option C) should set the organisation's 'risk profile'. Industry and economic factors (Option B), such as competition or finance costs, influence business risk.

Also, see the definition of business risk in ISA 315 (revised) *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment*, para. 4.

Option D is incorrect because reconciliations are controls, and the failure to complete reconciliations creates control risk rather than business risk.

You can review this topic area in Module 3 in the section titled 'Identifying and assessing the risks of material misstatement through understanding the entity and its environment'.

Question 3.3

Correct answer: B

The correct answer is Option B because accounts receivable turnover will decrease if year-end accounts receivable increase. Option B is correct because relaxation of credit policy will result in sales to new customers who are less credit worthy and are likely to take longer to pay, and will therefore result in an increase in receivables.

Options A, C and D are incorrect because they are policies that will decrease the accounts receivable end of year balance.

You can review this topic area in Module 3 in the section titled 'Analytical procedures'.

Question 3.4

Correct answer: A

The correct answer is Option A because an increase in interest rates will increase the fixed costs of the business and so increase finance risk.

Option B is incorrect because sample sizes relate to audit risk, not to business risk.

Option C is incorrect because a decrease in inflation will decrease costs below expectations.

Option D is incorrect because an increase in economic growth will increase revenues.

You can review this topic area in Module 3 in the section titled 'Identifying and assessing the risks of material misstatement through understanding the entity and its environment'.

Question 3.5

Correct answer: A

The correct answer is Option A because having a narrow product line is an internal weakness, not an external threat.

Option B is incorrect because restrictive legislation is an external threat.

Option C is incorrect because the introduction of substitute products is an external threat.

Option D is incorrect because fluctuation in the value of the Australian dollar is an external threat.

You can review this topic area in Module 3 in the section titled 'Techniques used in strategic analysis', in particular Table 3.3.

Question 3.6

Correct answer: B

The correct answer is Option B because an increase in customer complaints could be due to a drop in quality of the products and may necessitate warranty work and discounting of stock. Audit risk would be in relation to overstatement of inventory and understatement of warranty expenses and accruals.

Options A and C are incorrect because no effect is expected in sales (Option A) or purchases (Option C).

Option D is incorrect because the effect would result in an understatement, not an overstatement, of warranty expenses.

You can review this topic area in Module 3 in the section titled 'Identifying and assessing the risks of material misstatement through understanding the entity and its environment'.

Question 3.7

Correct answer: A, B and D

The correct answer is Options A, B and D. The auditor must document their strategy, plan and significant changes. All three items are identified in ISA 300 *Planning an Audit of Financial Statements*, para. 12.

Option C is incorrect because some flexibility in the assignment of audit team personnel is required. Some jobs will require less or more resources than planned.

You can review this topic area in Module 3 in the section titled 'Planning an audit of financial statements'.

Question 3.8

Correct answer: A

The correct answer is Option A because the concern should be that sales are moved from January back to December. This is a cut-off issue. The auditor should also be concerned about the occurrence of sales, but this is not an option here.

Options B, C and D are incorrect because the risk relating to the other assertions regarding sales is not affected by the issue identified.

You can review this topic area in Module 3 in the section titled 'Financial statement assertions'.

Question 3.9

Correct answer: B

The correct answer is Option B because understatement is the main issue for liabilities and therefore the completeness assertion is critical.

Option A is incorrect because it is unusual to find that liabilities are overstated.

Option C is incorrect because liabilities that are disclosed normally represent existing obligations. This is a low risk assertion.

Option D is incorrect because valuation is also a secondary consideration.

You can review this topic area in Module 3 in the section titled 'Financial statement assertions'.

Question 3.10

Correct answer: D

The correct answer is Option D because the auditor is concerned with the client understating interest expense to avoid exceeding the interest cover ratio. Therefore, completeness is the key assertion at risk.

Option A is incorrect because although it is important, it is secondary. Cut off has some lesser relevance to understatement.

Option B is incorrect because although it is important, it is secondary. Accuracy also has some lesser relevance to understatement.

Option C is incorrect because although it is important, it is secondary. Occurrence relates to overstatement.

Given the ease of calculating interest expense based on disclosed debt obligations, normally interest expense can be determined in a straightforward manner.

You can review this topic area in Module 3 in the section titled 'Financial statement assertions'.

Question 3.11

Correct answer: D

The correct answer is Option D because given the competitive industry and short life cycle, valuation and allocation is the key assertion for inventory. There is a risk that much of the inventory might be obsolete, so overvalued.

Existence and rights are not insignificant risks and must be tested, but due to the nature of the business, these risks are of less importance than valuation.

Option A is incorrect because there is lower risk that non-existent inventory has been fraudulently recorded.

Option B is incorrect because there is lower risk of inventory understatement.

Option C is incorrect because there is a lower risk that inventory belongs to others.

You can review this topic area in Module 3 in the section titled 'Financial statement assertions'.

Question 3.12

Correct answer: A

The correct answer is Option A because given the thefts of inventory, existence is the key assertion at risk.

Options B and D are incorrect. While valuation and rights and obligations are important, they are of lower risk than existence.

Option C is incorrect because completeness is not normally an issue with assets—the main risk with assets is overvaluation.

You can review this topic area in Module 3 in the section titled 'Financial statement assertions'.

Question 3.13

Correct answer: A

The correct answer is Option A. ISA 315 (revised) *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*, para. A124 states, 'Assertion used by the auditor to consider the different types of potential misstatements that may occur fall into three categories'.

Option A is not one of the categories listed in ISA 315 (revised).

Option B is incorrect because presentation and disclosure is one of the categories of assertions identified in ISA 315 (revised).

Option C is incorrect because account balances at the period end is one of the categories of assertions identified in ISA 315 (revised).

Option D is incorrect because classes of transactions and events for the period under audit is one of the categories of assertions identified in ISA 315 (revised).

You can review this topic area in Module 3 in the section titled 'Financial statement assertions'.

Question 3.14

Correct answer: D

The correct answer is Option D because controls over the output of accounting applications are considered application controls since they relate to a specific accounting application.

Options A, B and C are incorrect because they are classified as general controls as they relate to all applications.

You can review this topic area in Module 3 in the section titled 'Controls in an IT environment'.

Question 3.15

Correct answer: C

The category of organisational and management controls include the proper segregation of incompatible functions and responsibilities within the IT department. How proper segregation is achieved is related to how the IT department is organised. Therefore Option C is correct.

Option A is incorrect because application controls pertain to specific applications or classes of transactions.

Option B is incorrect because system software relates to the operating systems that are designed to translate program languages into machine-readable form, allocate computer resources to users and applications, and manage job scheduling.

Option D is incorrect because it relates to the software change process rather than the way the IT department is organised.

You can review this topic area in Module 3 in the section titled 'Controls in an IT environment'.

Question 3.16

Correct answer: B

The correct answer is Option B. The difference between the quick and current ratios is the inclusion of inventory in the current ratios. Accounts receivable is included in both the current and quick ratios. An increase in inventory means current assets are higher and, therefore, the current ratio is higher (e.g. purchased inventory is greater than COGS for this period).

Option A is incorrect because this would cause the current ratio to decrease and have no effect on the quick ratio.

Options C and D are incorrect because accounts receivable is included in both ratios, and a change in accounts receivable would move both the current and the quick ratios in the same direction.

You can review this topic area in Module 3 in the section titled 'Analytical procedures'.

Question 3.17

Correct answer: A

The correct answer is Option A. Sales have increased and net income as a percentage of sales has increased, therefore net income must have increased overall. However, we see that return on equity is down. This can only have happened if equity increased quite a lot.

Option B is incorrect because long-term debt has decreased.

Option C is incorrect because total debt has decreased.

Option D is incorrect because we have no measure in the table indicating the cost of debt.

You can review this topic area in Module 3 in the section titled 'Analytical procedures'.

Question 3.18

Correct answer: B

The correct answer is Option B. Expo's net investment in plant and equipment has decreased during the three-year period 20X2–20X4. This conclusion is reached by using the sales-to-fixed-assets (fixed asset turnover) and sales-as-a-percent-of-20X2-sales ratios as follows

Sales to fixed assets have increased 1.78 / 1.57 = 1.13x.
Sales have increased 1.05 / 1.00 = 1.05x.
Therefore, fixed assets must have decreased. This can be worked out as 1.05 / 1.13 = 0.93x.

Options A, C and D are incorrect because they would not result in the changes in the ratios identified above.

You can review this topic area in Module 3 in the section titled 'Analytical procedures'.

Question 3.19

Correct answer: B

The correct answer is Option B because it is identified as one procedure the auditor should carry out in order to assess the risk of material misstatement in ISA 315 (revised), para. 26(c).

Option A is incorrect because this is a procedure used to provide corroboration of evidence obtained through oral enquiries of management and other substantive procedures. It is a risk identification rather than a risk assessment procedure.

Option C is incorrect because risks have no direct bearing on the auditor's report.

Option D is incorrect because this is a risk identification procedure rather than a risk assessment procedure.

You can review this topic area in Module 3 in the section titled 'Assess the risks of material misstatement'.

Question 3.20

Correct answer: D

The correct answer is Option D because this procedure is a test that all sales as evidenced by shipments have been recorded and so it is a completeness test.

Option A is incorrect because this test is related to the cut-off assertion for sales, and will therefore only test for misallocated sales around year end.

Option B is incorrect because this is primarily a test of the valuation and allocation assertion; it determines the collectability of the account.

Option C is incorrect because this is part of the testing for the valuation and allocation assertion for the account. The second part of this test is to estimate the allowance for doubtful debts, determined on the basis of the ageing.

You can review this topic area in Module 3 in the section titled 'Financial statement assertions'.

Question 3.21

Correct answer: C

In determining the audit strategy, the auditor would review the internal control system with the aim of identifying key controls on which to rely. However, at the planning stage, the auditor would not test these controls. This testing would occur in the early stages of the implementation of the audit plan.

Options A, B, and D are incorrect. All are listed in the appendix of ISA 300 *Planning an Audit of Financial Statements*.

You can review this topic area in Module 3 in the section titled 'Planning an audit of financial statements'.

Module 4

Question 4.1

Correct answer: B and C

The correct answer is Options B and C. Option B is correct as per the discussion in the module regarding internal controls. Some internal controls may not provide a visible record of their existence. For example, the effectiveness of gate security at a warehouse controlling goods leaving the premises is unlikely to create a visible audit trail. Observing this control at a particular time does not provide evidence that this control has operated for the period of the audit, thus there is not good evidence of continuity of the control operation.

Option C is correct because cost-flow assumptions like FIFO relate to the valuation and allocation assertion, and not to the existence of inventory.

Option A is incorrect because obsolescence will be relevant for assessing the valuation and allocation assertion, not the existence assertion.

Option D is incorrect because inventory cut-off is assessed by examining both inventory receipts and shipments prior to, and following, the balance date. Sales transactions throughout the year are not relevant to the cut-off test. Further, sales transactions are only relevant to shipments, but not receipts of inventory. A proper cut-off test would examine purchase and sales transactions in the two-week period surrounding the balance date. Purchases are generally recorded when received, and sales are generally recorded when inventory is shipped.

You can review this topic area in Module 4 in the sections titled 'Sufficient appropriate audit evidence' and 'Tests of controls'.

Question 4.2

Correct answer: C

The correct answer is Option C because this is a test of control as outlined in the study guide under the heading 'Tests of controls procedures'.

Option A is incorrect because it is a substantive analytical procedure (i.e. it is a reasonableness test as described in the study guide under the heading 'The use of substantive analytical procedures as reasonableness tests').

Option B is incorrect because it is a substantive test of detail as described in the study guide under the heading 'Tests of detail'. It confirms the existence and valuation of cash.

Option D is incorrect because it is an example of the use of generalised audit software as illustrated in the study guide under the heading 'Using audit software for substantive testing'. It is a substantive audit procedure to ascertain the valuation of accounts receivable.

You can review this topic area in Module 4 in the section titled 'Substantive audit procedures'.

Question 4.3

Correct answer: C

The correct answer is Option C. The undertaking of a sequence check of the numbering of tax receipts for any unauthorised or duplicate receipts would be a test for the occurrence of fundraising revenue, not completeness—the assertion identified as at risk. A possible sequence check procedure of the numbering of tax receipts for completeness would be to look for missing receipt numbers.

Options A, B and D are identified in Appendix 1 of GS 019 as appropriate indicative audit procedures with regards to the completeness of cash donations.

Option A is incorrect because it is a valid procedure. The reconciliation of cash against the total of tax receipts issued provides a substantive test of both the existence and completeness of revenue.

Option B is incorrect because it is a valid procedure. It tests the physical security of the money boxes to ensure that they have not been tampered with and donations potentially taken before they are counted.

Option D is incorrect because it is a valid procedure as it is a test of controls over collectors.

You can review this topic area in Module 4 in the section titled 'Tests of controls'. See also Case study 4.1 and its solution.

Question 4.4

Correct answer: A

The correct answer is Option A because test data techniques are suitable for tests of controls and are not used for substantive tests.

Option B is incorrect because utility programs are common programs that may be used for data access and manipulation to help substantively verify the client's transactions and accounting records.

Options C and D are incorrect because they refer to programs designed for auditors that normally have built-in substantive testing functions for the client's transactions and accounting records.

You can review this topic area in Module 4 in the section titled 'Tests of controls' under 'Test data' and in the section titled 'Substantive audit procedures' under 'Using audit software for substantive testing'.

Question 4.5

Correct answer: D

The correct answer is Option D because it highlights possible obsolescence—those items where there may be difficulty selling inventory on hand—and is therefore directly related to the valuation and allocation assertion for inventory.

Option A is incorrect because it is not a useful exception report as all it does is highlight inventory items where the quantity on hand has increased over the year.

Options B and C are incorrect because they are not exception reports, in that they both involve only a comparison of master file totals. They are not designed to identify unusual items or unexpected relationships in account balances or transactions.

You can review this topic area in Module 4 in the section titled 'Substantive audit procedures' under 'Using audit software for substantive testing'.

Question 4.6

Correct answer: A

The correct answer is Option A because this is an example of block selection, which is not usually a permitted sampling technique (refer to ISA 530 *Audit Sampling*, Appendix 4). It may be that the 20 items listed together on page 3 are similar in nature (e.g. if listed by inventory number or alphabetically).

According to Appendix 4: 'Block selection cannot ordinarily be used in audit sampling because most populations are structured such that items in a sequence can be expected to have similar characteristics to each other, but different characteristics from items elsewhere in the population'.

Option B is incorrect because it is an example of systematic selection, which is a common sampling method permitted under ISA 530 that will allow a representative sample of the population to be selected.

Option C is incorrect because it is random sampling, which is also a common sampling method permitted under ISA 530 that will allow a representative sample of the population to be selected.

Option D is incorrect because it is haphazard sampling, which is also a common sampling method permitted under ISA 530 that will allow a representative sample of the population to be selected.

You can review this topic area in Module 4 in the section titled 'Tests of controls' under 'Sampling techniques for testing controls' and in the section titled 'Substantive audit procedures' under 'Sampling techniques in substantive procedures'.

Question 4.7

Correct answer: C

The correct answer is Option C because random selection aims at ensuring that each item in a population has a chance at selection.

Option A is incorrect because items can be sampled with or without replacement, and are more commonly sampled without replacement. There is no benefit to selecting an item twice.

Option B is incorrect because it is the selection that is random and the population ordering is unimportant.

Option D is incorrect because population stratification is not considered. This is a separate and more advanced technique that may improve the efficiency of the selection process.

You can review this topic area in Module 4 in the section titled 'Tests of controls' under 'Sampling techniques for testing controls'.

Question 4.8

Correct answer: D

The correct answer is Option D. The main reason that an auditor undertakes substantive analytical procedures is because they are an efficient and effective way of gathering audit evidence and can reduce the required level of testing of details that would need to be undertaken on associated accounts.

Option A is incorrect because the standards now differ between analytical procedures used as risk assessment procedures and substantive analytical procedures. Analytical procedures used as risk assessment procedures may identify unusual transactions of a material nature. Substantive analytical procedures are a substantive technique, and are not aimed at tests of controls, meaning that the control testing nature of Options B and C are also incorrect.

You can review this topic area in Module 4 in the section titled 'Substantive audit procedures' under 'Substantive analytical procedures'.

Question 4.9

Correct answer: C

The correct answer is Option C because the existence and valuation and allocation assertions are both covered by tracing to subsequent receipts.

Options A and B are incorrect because confirmation procedures are not seen to be a useful check of valuation and allocation because they do not provide any audit evidence as to whether the debtor is expected to pay the debt.

Option D is incorrect because vouching of related transactions would be evidence of occurrence of transactions rather than existence, and again the audit procedure provides no evidence as to whether the debt outstanding will be paid.

You can review this topic area in Module 4 in the section titled 'Substantive audit procedures' under 'Tests of details'.

Question 4.10

Correct answer: B

The correct answer is Option B. The best way to gain direct evidence that a programmed control (such as an online access control) is working is through the use of test data techniques. The auditor can directly test whether password controls are working by attempting entry into the system by using invalid identifications and passwords.

Option A is incorrect because vouching a random sample of transactions only gives indirect evidence of controls.

Options C and D are incorrect because they involve checking after the data has been processed, and do not involve directly testing the online access controls.

You can review this topic area in Module 4 in the section titled 'Evidence-gathering in an e-commerce environment' under 'Tests of controls in an e-commerce environment'.

Question 4.11

Correct answer: C

The correct answer is Option C. The professional training of the Head of Internal Auditing and their being a member of the Institute of Internal Auditors will be related to the assessment of the technical competence of the internal auditor.

Options A, B and D are incorrect because they are all related to the assessment of the objectivity (organisational status and scope of function) of internal audit. They do not relate to the internal auditor's technical competence.

You can review this topic area in Module 4 in the section titled 'Using the work of other auditors and experts' under 'Internal auditors'.

Question 4.12

Correct answer: D

The correct answer is Option D. A primary use of generalised audit software (GAS) packages is to select and summarise a client's records for additional testing. These packages permit the auditor to extract, compare, analyse and summarise data, and to generate output for use in the audit. They allow the auditor to exploit the computer to examine many more records than otherwise possible, with far greater speed and accuracy. Although GAS requires the auditor to provide certain specifications about the particular client's records, computer equipment and file formats, a detailed knowledge of the client's system may be unnecessary because the audit package is designed to be used in many environments.

Option A is incorrect because the level of required testing of controls is not necessarily associated with the use of GAS.

Option B is incorrect because testing a master file does not necessarily result in testing of transaction data (these may not even be recorded on the master file) or permit testing of controls associated with the transactions.

Option C is incorrect because the type of substantive procedures undertaken is not necessarily associated with the use of GAS.

You can review this topic area in Module 4 in the section titled 'Substantive audit procedures' under 'Using audit software for substantive testing'.

Question 4.13

Correct answer: D

The correct answer is Option D because audit software is able to read the file, compare the balances with the credit limits and print out an exception report of those customers whose credit limits have been exceeded. The auditor can then use these reports to seek explanations as to why this has occurred.

Options A and B are incorrect because they involve unnecessary manual checking, and are more prone to human error.

Option C is incorrect because test data relates to the testing of controls, and will not give confidence regarding whether or not credit limits are exceeded at the end of the year.

You can review this topic area in Module 4 in the section titled 'Substantive audit procedures' under 'Using audit software for substantive testing'.

Question 4.14

Correct answer: C

The correct answer is Option C because, using an integrated test facility (ITF), the auditor creates a test record within the client's actual system. Fictitious transactions affecting the test record along with actual transactions are processed. Client operating personnel need not be aware of the testing process.

Option A is incorrect because parallel simulation involves the comparison of transactions being run through two programs: the client's program and a program under the auditor's control.

Option B is incorrect because program code review involves going over the relevant code line by line and considers whether the processing steps and control procedures are properly coded and logically correct.

Option D is incorrect because GAS consists of a set of computer programs designed to perform audit functions that would traditionally have been performed manually. The computer programs are essentially data manipulation and output programs that are adaptable to various data formats and computer systems.

You can review this topic area in Module 4 in the section titled 'Tests of controls' under 'Integrated test facility (ITF)'.

Question 4.15

Correct answer: C

The correct answer is Option C because utilities are reliable and are usually specific to a piece of computer hardware. Because they are generally supplied by hardware or software manufacturers, they are usually extensively tested.

Option A is incorrect because auditors would not want to change the client's data files.

Option B is incorrect because application programs are specific to accounting functions like inventory, while utilities are usually designed for specific computer hardware.

Option D is incorrect because utility packages are usually specific to particular computer systems.

You can review this topic area in Module 4 in the section titled 'Substantive audit procedures' under 'Using audit software for substantive testing'.

Question 4.16

Correct answer: C

The correct answer is Option C because the acquisition is material and of interest to users, so should be disclosed. However, the event does not require any adjustment to the 30 June financial statements.

Option A is incorrect because it is not a matter that will affect the financial statements and requires no disclosure.

Option B is incorrect because, if material, it would require adjustment to the inventory account in the financial statements. No disclosure of this adjustment is required.

Option D is incorrect because it requires no action given that it is immaterial.

You can review this topic area in Module 4 in the section titled 'Subsequent events'.

Question 4.17

Correct answer: D

The correct answer is Option D because a management representation letter is addressed by management to auditors and confirms in writing any statements of opinion (representations) made by management to the auditors during the course of an audit.

Option A is incorrect because a management letter is a letter to management from the auditor detailing suggestions arising from the audit for improvement to the accounting controls or other accounting matters.

Option B is incorrect because an engagement letter outlines the terms of the audit engagement.

Option C is incorrect because it is a made-up name. An 'audit representation letter' is not the name of any relevant document.

You can review this topic area in Module 4 in the section titled 'Completion' under 'Management representation letters'.

Question 4.18

Correct answer: D

The correct answer is Option D. As outlined in the study guide, the need for computer-assisted audit techniques (CAATs) is likely to increase with the level of integration of the e-commerce systems with other operating systems, the complexities of the systems in use, the assessment of risk and the availability of audit trails.

Options A, B and C are incorrect because many programmed controls are used in e-commerce environments, and these can be tested through CAATs like integrated test facilities and test data.

You can review this topic area in Module 4 in the section titled 'Evidence-gathering in an e-commerce environment' under 'The use of CAATs in an e-commerce environment'.

Question 4.19

Correct answer: B

The correct answer is Option B because debtors' confirmation techniques are an appropriate technique for determining material misstatements associated with the existence assertion for debtors. The existence assertion is more likely to be materially misstated when the incentive is to overstate profits (overstate revenue by including non-existent sales and debtors, with the entry 'Dr: Debtors Cr: Sales revenue'). Thus the technique is more likely to be extensively used by the auditor for Company Y than for Company X (where the incentive is to understate sales revenue and debtors).

Options A and C are incorrect because debtors' confirmation techniques are more likely to be extensively used by the auditor for Company Y than for Company X. This automatically means that Options A and C are incorrect.

Option D is incorrect because debtors' confirmation techniques are useful and appropriate audit techniques for small company audits.

You can review this topic area in Module 4 in the section titled 'Sufficient appropriate audit evidence' under 'Financial statement assertions' and the section titled 'Substantive audit procedures' under 'Tests of details'.

Question 4.20

Correct answer: B

The correct answer is Option B because this is the least useful audit procedure in this circumstance. Related party transactions have already occurred and so are unlikely to provide relief from going concern problems. Related parties can sometimes be a useful source of finance, but past transactions give no indication of this.

As outlined in the study guide, Options A, C and D are incorrect because they are all recommended audit procedures when the auditor has concluded that a significant going concern uncertainty exists (ISA 570, para. A15).

You can review this topic area in Module 4 in the section titled 'Advanced evidence-gathering issues' under 'Audit procedures for assessing going concern issues'.

Question 4.21

Correct answer: C

The correct answer is Option C because detection risk is related to the nature, extent and timing of substantive testing. An appropriate response to a decrease in the acceptable level of detection risk is to introduce more reliable substantive procedures. A positive external confirmation procedure provides more reliable audit evidence than a negative external confirmation procedure (refer to ISA 505 *External Confirmations*, paras 15 and A23).

Option A is incorrect because the auditor has no control over inherent risk. Detection risk will be set in relation to inherent risk, rather than the reverse, as is implied by this option.

Option B is incorrect because it applies to assessing control risk.

Option D is incorrect because shifting the test away from the year end will increase detection risk.

You can review this topic area in Module 4 in the section titled 'Sufficient appropriate audit evidence'.

Module 5

Question 5.1

Correct answer: A

The correct answer is Option A because this will result in a situation where the auditor is unable to obtain sufficient appropriate audit evidence to preclude an unmodified opinion. When an auditor requests written representations and they are not provided by management, ISA 580, para. 20, states that the auditor shall disclaim an opinion on the financial statements if management does not provide required written representations. Such an action by management raises doubts for the auditor about management's integrity.

Options B and D are incorrect because there are no acceptable alternative sources of evidence.

Option C is incorrect because there is no alternative evidence to written representations provided by management.

You can review this topic area in Module 5 in the section titled 'Types of auditor's report'.

Question 5.2

Correct answer: D

The correct answer is Option D because this is a situation where the auditor is unable to obtain sufficient appropriate audit evidence that will result in either a qualified or a disclaimer of opinion being issued. The distinction between a qualified opinion and a disclaimer opinion will depend on the extent of the limitation—whether the auditor considers the limitation to be capable of explanation to users in the basis for modification paragraph in the auditor's report, or it is pervasive and makes the financial statements as a whole misleading.

Options A and C are incorrect because they reference an adverse opinion, which does not suit situations where the auditor is unable to obtain sufficient appropriate audit evidence.

Option B is incorrect because it is only part of the correct answer. A disclaimer is issued only when the inability to obtain sufficient appropriate audit evidence is pervasive.

You can review this topic area in Module 5 in the section titled 'Types of auditor's report'.

Question 5.3

Correct answer: A

The correct answer is Option A. This is a situation where the financial statements are materially misstated as a result of the inappropriate application of an accounting standard, the effects of which are material but are not expected to be pervasive to the financial statements. The auditor should be able to provide a suitable explanation of the misstatement in the auditor's report, detailing its nature and effect on the financial statements.

Options B and D are incorrect because they are appropriate when the misstatement (adverse) or limitation (disclaimer) is pervasive.

Option C is incorrect because the misstatement is material.

You can review this topic area in Module 5 in the section titled 'Types of auditor's report'.

Question 5.4

Correct answer: A

The correct answer is Option A because this is a situation where the financial statements are materially misstated as a result of the inappropriate application of an accounting standard. The amount is material but not pervasive to the financial statements. Therefore, a qualified opinion is required.

Option B is incorrect because the misstatement is not pervasive to the financial statements.

Option C is incorrect because the financial statements are materially misstated, requiring a modification to the auditor's report.

Option D is incorrect because the misstatement is material. An Emphasis of Matter paragraph is used when the financial statements are presented fairly, but the auditor wishes to draw users' attention to something in the financial statements that is of particular significance.

You can review this topic area in Module 5 in the section titled 'Types of auditor's report'.

Question 5.5

Correct answer: A

The correct answer is Option A because this is a situation where the financial statements are materially misstated over the required disclosure of an amount. Directors' emoluments must be disclosed irrespective of the amount involved. Therefore, it is material by its nature, but not pervasive. A qualified opinion is required.

Options B and C are incorrect because they are appropriate when the misstatement (adverse) or limitation (disclaimer) is pervasive.

Option D is incorrect because the misstatement is material. An Emphasis of Matter paragraph is used when the financial statements are presented fairly, but the auditor wishes to draw users' attention to something in the financial statements that is of particular significance.

You can review this topic area in Module 5 in the section titled 'Types of auditor's report'.

Question 5.6

Correct answer: D

The correct answer is Option D because this represents a significant uncertainty that the auditor agrees is adequately disclosed in the notes to the financial statements and, therefore, an unmodified opinion with an Emphasis of Matter paragraph is required.

There is no misstatement, so none of Options A, B or C is appropriate and they are therefore incorrect.

You can review this topic area in Module 5 in the section titled 'Types of auditor's report'.

Question 5.7

Correct answer: B

The correct answer is Option B because a complex judgment about the most appropriate basis for revenue recognition is a matter of audit significance that meets all the requirements for disclosure. It is an area of higher assessed risk of material misstatement, significant auditor judgment relating to disclosures that involve significant management judgment, and it will have a significant effect on the audit.

Option A is incorrect because it involves a disclosure that is industry wide and a well-known risk that is recognised by the broader community.

Options C and D are incorrect as they involve disagreements with management about the adequacy of disclosures that will result in a modified auditor's opinion.

You can review this topic area in Module 5 in the section titled Types of auditor's report' under 'Key audit matters'.

Question 5.8

Correct answer: C

The correct answer is Option C because the inability to obtain audited financial statements supporting the entity's investment in its major subsidiary is an extreme situation where the auditor is unable to obtain sufficient appropriate audit evidence. This would result in a disclaimer of opinion.

Option A is incorrect because a qualification would be inadequate to disclose the pervasive effect on the consolidated financial statements of the inability to obtain audited financial statements for the entity's major foreign subsidiary.

Option B is incorrect because there is no evidence regarding a misstatement.

Option D is incorrect because an unmodified opinion would be inadequate.

You can review this topic area in Module 5 in the section titled 'Types of auditor's report'.

Question 5.9

Correct answer: C

The correct answer is Option C because the auditor's report would be unmodified in respect of the entity's compliance with the legislative requirements, but modified in respect of compliance with International Financial Reporting Standards.

Option A is incorrect because it only is partly correct. It does not reflect the fact that the auditor's report would be unmodified in respect of the entity's compliance with the legislative requirements.

Option B is incorrect because an adverse opinion is inappropriate as the misstatement is not pervasive.

Option D is incorrect because an unmodified opinion is inadequate to reflect the fact that the financial statements do not comply with International Financial Reporting Standards.

You can review this topic area in Module 5 in the section titled 'Types of auditor's report'.

Question 5.10

Correct answer: A

The correct answer is Option A. The auditor's report would be modified on the basis of a lack of disclosure and, as the effect is material but not extreme, the auditor's report would be a qualified opinion.

Option B is incorrect because a disclaimer is inappropriate as the lack of disclosure will not be pervasive to the financial statements.

Option C is incorrect because, as noted in ISA 706 (revised), para A15, 'The content of an Other Matter paragraph reflects clearly that such other matter is not required to be presented and disclosed in the financial statements'. In this case, the auditor believes that disclosure is required, so the use of an Other Matter paragraph is not appropriate.

Option D is incorrect because the lawsuit is not discussed in the financial statements, so there is nothing to emphasise.

You can review this topic area in Module 5 in the section titled 'Types of auditor's report'.

Question 5.11

Correct answer: A

The correct answer is Option A. The auditor's report explicitly contains sections that outline:

- the responsibilities of management and those charged with governance for the financial statements; and
- the auditor's responsibilities for the audit of the financial statements.

Options B, C and D are incorrect because each option includes the term 'implicitly'. In all engagements, both responsibilities must be clearly spelled out in separate sections. The term implicitly means that the responsibilities are implied, which is not the case.

You can review this topic area in Module 5 in the sections titled 'Reporting responsibilities for audits of financial statements' and 'Types of auditor's report', in particular the example of the 'Standard (unmodified) auditor's report'.

Question 5.12

Correct answer: D

The correct answer is Option D. An unjustified accounting change is a disagreement with management and would result in a qualified or adverse opinion.

Options A, B and C are incorrect because they are situations where the auditor is unable to obtain sufficient appropriate audit evidence. The auditor is unable to obtain audit evidence that they regard as important to the engagement. Such situations may give rise to a disclaimer of opinion if they are pervasive, indicating that the auditor is unable to form an opinion on the financial statements as a whole.

You can review this topic area in Module 5 in the section titled 'Types of auditor's report'.

Question 5.13

Correct answer: B

The correct answer is Option B. The audit of the concise financial report should be treated as a separate engagement from the audit of the full financial statements.

As an appropriate form of assurance, all of the standards governing assurance are applicable.

Option A is incorrect because an Emphasis of Matter is possible.

Option C is incorrect because the opinion paragraph will be worded differently, outlining whether, in all material respects, the concise financial report complies with the requirements of AASB 1039.

Option D is incorrect because specific additional audit procedures related to the additional disclosures in the concise financial report are required for the engagement.

You can review this topic area in Module 5 in the section titled 'Audits of specialised areas' under 'Auditor's reporting on concise financial reports'.

Question 5.14

Correct answer: C

The correct answer is Option C. The most common wording contained in the auditor's report for a reasonable assurance engagement when determining compliance with a compliance framework is that the financial statements are prepared in accordance with the framework.

Options A and B are incorrect because this wording is associated with a fair presentation framework. Fair presentation is not considered in a compliance framework. The phrases 'true and fair' and 'present fairly' indicate fair presentation frameworks.

Option D is incorrect because this wording is appropriate to a limited assurance engagement.

You can review this topic area in Module 5 in the section titled 'Fair presentation and compliance frameworks (true and fair override)'.

Question 5.15

Correct answer: B

The correct answer is Option B because the assurance provider does not normally undertake tests of controls as part of a limited assurance engagement.

Option A is incorrect because the comparison of the financial statements with budgets is an analytic procedure commonly carried out in review engagements.

Options C and D are incorrect because the procedures that are undertaken for limited assurance engagements are principally inquiries of company personnel.

You can review this topic area in Module 5 in the section titled 'Reports providing limited assurance' under 'Review of interim financial information performed by the auditor of the entity'.

Question 5.16

Correct answer: A and B

The correct answer is Options A and B. Compilation and agreed-upon procedures engagements are not assurance engagements so provide no assurance.

Option C is incorrect because ISAE 3400 *The Examination of Prospective Financial Information* specifically addresses assurance issues in relation to hypothetical information and projections. Audits of prospective financial information are a very common form of assurance engagement. The auditor's objective with respect to hypothetical assumptions is to determine whether assumptions are consistent with the purpose of the information.

Option D is incorrect because, in common with all other forms of review, a review of financial information where the assurance provider is not the auditor of the entity provides limited assurance.

You can review this topic area in Module 5 in the sections titled 'Reports providing no assurance' and 'Reports providing limited assurance'.

Question 5.17

Correct answer: B

The correct answer is Option B. Agreed-upon procedures engagements require a statement that the distribution of the report will be restricted to specified parties (ISRS 4400, para. 9).

Option A is incorrect because it is a conclusion appropriate to a reasonable assurance engagement.

Option C is incorrect because an agreed-upon procedures engagement should contain a statement that the procedures performed were those agreed with the recipient.

Option D is incorrect because it is a conclusion appropriate to a limited assurance engagement.

You can review this topic area in Module 5 in the section titled 'Reports providing no assurance' under 'Agreed-upon procedures'.

Question 5.18

Correct answer: D

The correct answer is Option D because the auditor has satisfied themselves that the matter is properly disclosed and so should issue an unmodified opinion. However, the existence of a significant uncertainty makes it necessary to include an Emphasis of Matter paragraph in the auditor's report drawing the reader's attention to this disclosure in accordance with ISA 706, para. 8.

Option A is incorrect. While the opinion should be unmodified, the uncertainty in the outcome of the lawsuit requires an Emphasis of Matter paragraph in the auditor's report.

Option B is incorrect. While the uncertainty is material, the auditor has no reason to believe the financial statements are misleading. Quite the opposite, the lawsuit has been properly disclosed and all information available to date has been provided.

Option C is incorrect. There is no indication that the auditor is unable to obtain sufficient appropriate audit evidence, as the auditor has satisfied themselves that the amount of the liability cannot be estimated at the present time. The matter is properly disclosed in the financial statements, so there is no disagreement with management.

You can review this topic area in Module 5 in the section titled 'Types of auditor's report'.

Question 5.19

Correct answer: D

The correct answer is Option D. When the auditor is satisfied that management plans will have a significant effect in reducing the going concern uncertainty to an acceptable level, the going concern assumption is satisfied. The uncertainty and associated management plans must be disclosed in the financial statements and a Material Uncertainty Related to Going Concern paragraph must be included in the auditor's report, drawing readers' attention to this disclosure.

Option A is incorrect because the going concern assumption is satisfied by management's plans and the financial statements can be prepared on a going concern basis.

Option B is incorrect because no modification of the auditor's opinion is required in these circumstances.

Option C is incorrect because there is a going concern uncertainty. Disclosure of this uncertainty is required in the financial statements and a Material Uncertainty Related to Going Concern paragraph is required to be included in the auditor's report, drawing readers' attention to this disclosure.

You can review this topic area in Module 5 in the section titled 'Auditor reporting for going concern and fraud'.

Question 5.20

Correct answer: D

The correct answer is Option D. According to ISA 570 (revised), para. 18, a material uncertainty exists when the magnitude of its potential impact and likelihood of occurrence is such that clear disclosure of the nature and implications of the uncertainty is necessary for the presentation of the financial statements not to be misleading. In such a case, the auditor must include a Material Uncertainty Related to Going Concern paragraph in the auditor's report (ISA 570 (revised), para. 22).

Option A is incorrect. A material uncertainty does not necessarily prevent the preparation of the financial statements on a going concern basis.

Option B is incorrect. A material uncertainty requires additional disclosure in the financial statements and the auditor's report.

Option C is incorrect. As noted above, the additional disclosure in the financial statements is appropriate, but the additional disclosure in the auditor's report must be included as well.

You can review this topic area in Module 5 in the section titled 'Auditor reporting for going concern and fraud'.

Question 5.21

Correct answer: D

The correct answer is Option D because this is a disagreement with management around a potentially material area. Thus, unless the auditor is able to gain comfort in other ways, the auditor shall consider the need to modify the auditor's report by issuing a qualified opinion or a disclaimer. The auditor should not include an Other Matter paragraph in the auditor's report, as this is not one of the situations outlined in ISA 706 (revised), para. 10, where an Other Matter paragraph is appropriate.

Option A is incorrect. The key to this question is the refusal of management to provide additional information to the auditor. Without this information, the auditor is unable to make a judgment as to the validity of the going concern assumption or the fair presentation of the financial statements.

Option B is incorrect. A qualified opinion is adequate in the circumstances, but the inclusion of an Other Matter paragraph is inappropriate as described above.

Option C is incorrect. An unqualified auditor's report is not appropriate given the disagreement with management.

You can review this topic area in Module 5 in the section titled 'Auditor reporting for going concern and fraud'.

Module 6

Question 6.1

Correct answer: D

Option D focuses on the outcome of a program—that is, street cleanliness.

Option B is incorrect because it is concerned with efficiency.

Options A and C are incorrect because they are concerned with economy.

You can review this topic area in Module 6 in the section titled 'Economy, efficiency and effectiveness'.

Question 6.2

Correct answer: A and C

The correct answer is Options A and C. Option A refers to effectiveness and Option C to economy and efficiency; effectiveness, economy and efficiency are all performance issues.

Option B is incorrect because it refers to a compliance audit.

Option D is incorrect because it refers to a financial statement audit.

You can review this topic area in Module 6 in the section titled 'Performance engagements—Definition and scope'.

Question 6.3

Correct answer: D

The correct answer is Option D. This relates to efficiency because it represents an increased output for the same level of input.

Options A and C are incorrect because they both relate to effectiveness.

Option B is incorrect because, though the tender process might lead to improved efficiency, no current improvement is noted.

You can review this topic area in Module 6 in the section titled 'Techniques for examining economy, efficiency and effectiveness'.

Question 6.4

Correct answer: A

The correct answer is Option A because this is an input, not an output indicator.

Options B, C and D are incorrect because they all refer to outcomes: support visits, planning applications, and kilometres of cable.

You can review this topic area in Module 6 in the section titled 'Performance indicators'.

Question 6.5

Correct answer: A, B and C

The correct answer is Options A, B and C. All criteria serve these three listed purposes. Unlike financial statement audits, one performance audit may differ from another in a variety of ways. In particular, what constitutes 'performance' may differ markedly from one performance audit to another, and established criteria may not be available for assessing performance. Accordingly, it is important for the auditor to create or adopt appropriate criteria. Clearly established criteria will enable management to understand the nature of the audit. It will also enable the auditor to establish the scope and plan appropriate procedures.

Option D is incorrect because performance audits are not necessarily efficiency audits. Often they are concerned with issues of economy or effectiveness outcomes rather than efficiency. Some performance audits, of course, are concerned with all three categories of performance.

You can review this topic area in Module 6 in the section titled 'Audit considerations'.

Question 6.6

Correct answer: D

The cause of an inefficient process is the basis of the recommendation for improvement. Unlike a financial statement audit, a performance audit aims to improve the performance of management. When it is determined that performance, however defined, is inconsistent with the auditor's criteria, the auditor should determine the cause of this inconsistency and make appropriate recommendations to management for improvement.

Options A and B are incorrect because these relate to the planning phase of the audit.
For Option A, the question refers to findings of the audit, so the audit must have 'proceeded'.
Similarly for Option B, audit findings cannot have been determined in the absence of criteria.

Option C is incorrect because it does not relate to the performance aspect of the audit, but to the financial statements.

You can review this topic area in Module 6 in the section titled 'Audit considerations'.

Question 6.7

Correct answer: D

The correct answer is Option D because audit criteria establish the auditor's expectations and the scope of the audit. Where audit evidence indicates that one or more of these expectations have not been met in some material way, the auditor should report this discrepancy.

Options A and B are incorrect because they are planning activities.

Option C is incorrect because the reporting of audit findings does not ensure the reasonableness of the criteria used.

You can review this topic area in Module 6 in the section titled 'Audit considerations'.

Question 6.8

Correct answer: D

The correct answer is Option D because the objective of a flu vaccination program is to reduce the number of cases of flu occurring. The program is effective if the objective is met.

Options A, B and C are all incorrect because they do not address, or identify, program objectives. Option A is a measure of economy, while Options B and C are outcome measures of efficiency.

You can review this topic area in Module 6 in the section titled 'Economy, efficiency and effectiveness'.

Question 6.9

Correct answer: D

Option D represents an economy measure because costs are reduced. The others are effectiveness and efficiency measures.

Option A is incorrect because 'shorter waiting lists' says nothing about cost or resource usage.

Option B is incorrect because 'better targeted incentives' implies that the incentives are being used in a more effective manner. If fewer incentives were required, the measure would be one of economy.

Option C is incorrect because it indicates the 'same inputs' are used. Economy would require fewer inputs be used.

You can review this topic area in Module 6 in the section titled 'Economy, efficiency and effectiveness'.

Question 6.10

Correct answer: D

Performance auditing, as defined, is concerned with economy, efficiency and effectiveness of the management of resources.

Options A and C are incorrect because they are secondary considerations that may or not be relevant in any particular performance audit.

Option B, the merit of government policy, is incorrect because it is not generally considered. Government policy is often used to establish the criteria for a performance audit, but the auditor does not generally assess the merits of this policy. In some instances the performance auditor might be asked to report on the means by which government policy is established.

You can review this topic area in Module 6 in the section titled 'Performance engagements—definition and scope'.

Question 6.11

Correct answer: D

The correct answer is Option D because regardless of the type of audit, the assurance provider must collect evidence, necessary and sufficient, to support conclusions that satisfy the audit objectives.

Option A is incorrect because the assurance practitioner in a financial statement audit is an independent auditor, while in a performance audit it is the Auditor-General.

Option B is incorrect because the subject matter in an audit of historical financial statements is those statements. These statements are not the subject of a performance audit.

Option C is incorrect because the criteria for an audit of historical financial information are the IFRS. Performance audits draw on a variety of criteria consistent with the audit objective.

You can review this topic area in Module 6 in the section titled 'Structure of a performance audit'.

Question 6.12

Correct answer: A, B and C

The correct answer is Options A, B and C because they are all significant differences in the report. Performance audits generally include a preliminary report (Option A). Understanding the cause of any deviation is fundamental to making recommendations for improvement (Option B). 'Conclusions' rather than 'opinions' are reported in a performance audit (Option C).

Option D is incorrect because a description of the responsibilities of management and of the auditor is required in all audit engagements.

You can review this topic area in Module 6 in the section titled 'The performance audit process'.

Question 6.13

Correct answer: A

The correct answer is Option A because the Auditor-General (AG) is responsible for auditing the financial reports and the performance of all government entities. The AG is independent of these entities, determining their own program of work and reporting directly to parliament.

Options B and D are incorrect because they are just partial descriptions of the AG's role. The AG's role includes the audit of financial reports of government entities (Option B), as well as performance audits (Option D).

Option C is incorrect because while the AG is responsible for the audit of the Department of Defence, the AG's role is far more extensive and includes audit of all government entities.

You can review this topic area in Module 6 in the section titled 'Background' under 'The role of auditors-general internationally'.

Question 6.14

Correct answer: C

The correct answer is Option C. The cause is the reason why something happened; it forms the basis of the recommendation to management about improving their practice.

Option A is incorrect because it does not relate to economy, efficiency or effectiveness.

Option B is incorrect because the effect (e.g. additional cost or waste) of a problem is important in determining its significance, but it provides no useful information to management about ways to improve their practice.

Option D is incorrect because assurance on the design and operation of the internal control system is important information for management, but what is required in a performance audit is a recommendation for improvement.

You can review this topic area in Module 6 in the section titled 'Cause and effect'.

Question 6.15

Correct answer: A

The correct answer is Option A. Effectiveness is a measure of the extent to which a program achieves its objectives. For example, a public housing project may create many homes (output), but it becomes effective if these homes are provided to the previously homeless people (outcome).

Option B is incorrect because this is efficiency.

Option C is incorrect because this is 'value for money'.

Option D is incorrect because this is economy.

You can review this topic area in Module 6 in the section titled 'Types of indicators'.

Question 6.16

Correct answer: B

The correct answer is Option B because the ratio compares outputs (treatments) to inputs (medical staff cost), so is an efficiency ratio.

Option A is incorrect because there is no assessment of the cost of the resources used (doctors and nurses).

Option C is incorrect because the number of treatments, the output measure, is not related to valid outcomes like cures or improvements to health. A hospital could be efficient but ineffective.

Option D is incorrect because value for money is a measure of the relationship between outcomes and resources used in creating those outcomes.

You can review this topic area in Module 6 in the section titled 'Types of indicators'.

Module 7

Question 7.1

Correct answer: A, B and D

The correct answer is Options A, B and D. These three arguments represent areas of competency that will aid the assurance provider in their provision of other assurance services.

Option C is incorrect because it relates to a core knowledge requirement for financial statement audits.

You can review this topic area in Module 7 in the section titled 'Core competencies for assurance practitioners.

Question 7.2

Correct answer: D

The correct answer is Option D. Verifiable means that the measure can be checked for its correctness, so that an independent assessment should result in similar conclusions. This checking is made possible by clarity about the method of calculation and the sourcing of inputs.

Option A is incorrect because it refers to clarity.

Option B is incorrect because it refers to comparability.

Option C is incorrect because the attribute it refers to is controllability.

Refer to the discussion on 'Criteria for performance measurement assurance' in the study guide.

You can review this topic area in Module 7 in the section titled 'Assurance on non-financial information: Business performance measurement'.

Question 7.3

Correct answer: B and D

The correct answer is Options B and D. Behaviour is what people do—their actions. Both Option B (corporate governance), and Option D (human resource policies) are behaviourally oriented subject matters.

Option A is incorrect because internal control relates to systems and processes.

Option C is incorrect because performance indicators relate to data.

You can review this topic area in Module 7 in the section titled 'The nature and characteristics of assurance services'.

Question 7.4

Correct answer: A, B and D

The correct answer is Options A, B and D. All are discussed as part of internal audit in the study guide under 'Internal audit', in the 'Carrying out the engagement' section.

Option C is incorrect. While internal auditors do provide assurance services, the focus of their work is oriented increasingly towards consulting and value adding, rather than compliance. Although internal auditors must be independent of management to be effective, they are employees and, as such, cannot demonstrate the level of independence of external auditors. It is external auditors who are called upon to provide assurance on the financial statements to external stakeholders like shareholders.

You can review this topic area in Module 7 in the section titled 'Internal audit', under 'Carrying out the engagement'.

Question 7.5

Correct answer: A

The correct answer is Option A. Performance indicators are 'data'.

Options B and C are incorrect because they relate to behaviour, including compliance with regulations.

Option D is incorrect because it relates to 'systems and processes'.

You can review this topic area in Module 7 in the section titled 'The nature and characteristics of assurance services'.

Question 7.6

Correct answer: A and D

Options A and D are discussed under 'The examination of prospective financial information' in the study guide. Projections are poorly understood, often being confused with forecasts. While forecasts have some basis in reasonable expectations about future events, projections are based on hypothetical outcomes, which may or may not be realistic.

Option B is incorrect. With regard to projections, the auditor does not form any opinion as to the reasonableness of management's hypothetical assumptions. The auditor's responsibility is simply to ensure that the implications of these assumptions are properly reflected in the prospective financial information.

Option C is incorrect because it relates to forecasts rather than projections.

You can review this topic area in Module 7 in the section titled 'Assurance on prospective financial information'.

Question 7.7

Correct answer: A and B

The correct answer is Options A and B. These are common internal audit functions.

Option C is incorrect. Risk identification and management is the responsibility of management. The internal auditor may be involved in the assessment of the effectiveness of these systems, but does not design or operate them.

Option D is incorrect because it is management that designs fraud controls and is responsible for their operation.

You can review this topic area in Module 7 in the section titled 'Nature of internal audit work'.

Question 7.8

Correct answer: C and D

The correct answer is Options C and D. Option C is the main established framework for an internal control assurance engagement. Option D refers to criteria developed by the assurance provider, which is permitted under ISAE 3000 if it is available to the intended users.

Option A is incorrect because it is an appropriate framework for an environmental and sustainability assurance engagement, but not for an internal control assurance engagement

Option B is incorrect because it is not a source of suitable criteria for an assurance engagement. Assurance criteria are not developed by the user of the report. Criteria used by an assurance provider will be taken from an established framework or developed by the assurance provider.

You can review this topic area in Module 7 in the section titled 'Assurance on systems and processes' and the section titled 'Assurance on non-financial information: Environmental and sustainability assurance'.

Question 7.9

Correct answer: C and D

The correct answer is Options C and D. These are internal audit activities to be carried out by the Chief Audit Executive. The Chief Audit Executive must confirm to the board at least annually the independence of internal audit activity.

Option A is incorrect. The approval of the internal audit plan is a board responsibility.

Option B is incorrect. The responsibility for the evaluation of the potential for fraud rests with management and is part of the risk management process, although it could be undertaken by the internal audit function.

You can review this topic area in Module 7 in the section titled 'Internal audit'.

Question 7.10

Correct answer: B

The correct answer is Option B. A forecast is prepared on the basis of assumptions as to future events and actions that management expects to take place. A projection is prepared on the basis of hypothetical assumptions about future events and management actions that are **not** necessarily expected to take place.

Option A is incorrect because the two are not the same.

Option C is incorrect because it has the two definitions reversed.

Option D is incorrect because it indicates that both are based on reasonable expectations, but this is not the case for a projection.

You can review this topic area in Module 7 in the section titled 'Assurance on prospective financial information'.

Question 7.11

Correct answer: D

The correct answer is Option D. When the issuer of a prospectus wants to illustrate the effect of planned acquisitions, it is common to adjust past financial statements. The adjusted statement demonstrates the effect of the acquisition had it taken place in the prior period. See ISAE 3420 *Assurance Engagements to Report on the Compilation of Pro Forma Historical Financial Information included in a Prospectus or other Document*.

Option A is incorrect because recommendations exist as to the expected format of the pro forma report.

Option B is incorrect because the pro forma information should be based on historical financial information, rather than prospective information.

Option C is incorrect because there is no expectation that the pro forma information will be extended for a number of years.

You can review this topic area in Module 7 in the section titled 'Assuring the compilation of pro forma financial information included in a prospectus'.

Question 7.12

Correct answer: D

The correct answer is Option D. The Global Reporting Initiative is an independent institution with the mission to develop and disseminate globally applicable sustainability reporting guidelines in order to establish a common framework for sustainability reporting.

Option A is incorrect. While the water accounting standard provides useful criteria for this one aspect of environmental performance, it does not provide sufficient criteria for a sustainability report.

Option B is incorrect. The ISAs are not criteria for assurance. They provide guidance on the conduct of an assurance engagement.

Option C is incorrect. The IFRS provide criteria for assurance on historical financial statements, not a sustainability report.

You can review this topic area in Module 7 in the section titled 'Assurance on non-financial information: Environmental and sustainability assurance'.

Extended Response Questions and Solutions

Contents

Extended Response Questions

Case Study—misstatement risk in inventory, accounts payable and cash

The following questions are related to the Harrier Peak Case Study, in particular, to the 20X8 audit plan. You need to have read the case study to work through this Knowledge Check.

Information about the inventory, accounts payable and cash cycle appears in many sections of the Harrier Peak Case Study, and relates to the years 20X6, 20X7 and 20X8. For your convenience, relevant information from the case is presented, along with some additional information that will assist you to answer the questions.

Summary of key information

Accounting system

In 20X4, Harrier Peak installed a popular accounting information system. No problems were identified in the conversion process during the 20X5 audit. The system is a relational database with accounting applications including:

- purchasing and accounts payable; and
- production and inventory.

Fraud

The bonus plan for the chief executive officer (CEO) is based on achieving certain profit-related targets. This provides an incentive to overstate profit by understating expenses or overstating revenues.

Sales

Internet sales are payable via credit card. Upon authorisation by the credit card company, a sales order enters the sales system:

1. an entry is made to record the sale and the receivable;
2. a pre-numbered shipping order is entered into the system and emailed to the Shipping Department; and
3. the company's inventory sub-ledger and the cost of goods sold is updated.

Cut-off

For internet sales, the company's sales and inventory systems are automatically updated when the pre-numbered shipping order is emailed to the Shipping Department. This raises questions regarding revenue recognition. Normally companies recognise revenue when goods are shipped, not when the sales order is received. This is an issue for transactions undertaken around balance date, where the recording of sales does not align with the revenue recognition test.

20X7 end-of-period journal entries

In any business it is highly surprising when sales are not recorded through a sales system. It is even more surprising that journal entries do not include a corresponding cost of goods sold (COGS)/inventory entry.

20X8 expansion—valuation and cut-off

There is an increased risk with the carrying value of assets in foreign currency. There is an increased risk of identifying when the sale is made and when inventory changes hands.

Customers
Any drop in household wealth or gross domestic product (GDP) in Australia, Asia or North America will affect demand. Potential exists for the build-up of unsold inventory and related valuation issues.

Supply and demand
The wine industry is depressed because of grape oversupply, growing retailer consolidation and a high Australian dollar reducing profits on export sales. Furthermore, there has been a fall in worldwide wine consumption (albeit only a 1% decrease). If these factors have made it more difficult for Harrier Peak to sell its inventory, the valuation and allocation assertion for inventory must be carefully examined.

Inventory
Harrier Peak produces wines from grapes grown in its own vineyards. Grapes are harvested at the end of summer, and all production is carried out at Margaret River. By year end (30 June), all of the year's production has been bottled and transferred from the winery to the finished goods warehouse. The number of brands (60 labels and several vintages) leads to complexity in valuing inventory.

20X6 revaluation
Harrier Peak revalued its leading brand of wine. The wine cost $25 a bottle to produce and was revalued to $50. It has a current market value of $100. There were 2500 bottles of the wine on hand as at 30 June 20X6. Inventory should be valued at the lower of cost and net realisable value. It should not be revalued upwards. The revaluation was reversed.

20X6 spoilage
A corkage (spoilage) problem and the related product returns mean that the auditor needs to pay particular attention to inventory and accounts receivable valuation related to this product. The client may have underestimated the level of returns, as the product was only released in April 20X6 and many bottles will still be on the shelves of bottle shops and restaurants. The inventory of the affected wine may be unsaleable.

20X8 expansion—valuation and cut-off
There is an increased risk with carrying value of assets in foreign currency.

Purchases
Requests for the purchase of supplies and other goods are received from the marketing manager and the winery manager. When requests are received, they are compared with the budget, and pre-numbered purchase orders are completed by the purchasing clerk. For each purchase order, the accounting system generates a pre-numbered receiving report, which is sent to the store person.

When goods are delivered, they are checked against the receiving report by the store person. If the shipment is correct, the store person approves the receiving report. Otherwise, discrepancies are noted and the receiving report is flagged for further attention (communication with the supplier).

Expense growth
The 20X8 expenses decreased when operations expanded (Asia and North America). Some expenses may have been inappropriately classified as assets such as inventory, or 'other financial assets'. In contrast, the balance of accounts payable has increased 69 per cent over the prior year. This appears excessive.

Payments
When suppliers' invoices are received, they are matched with purchase orders and receiving reports. If all is in order, the documents are cancelled, and the expense or asset accounts in the general ledger and the creditor's sub-ledger are updated. Payment is scheduled in keeping with agreed purchase terms. Discrepancies are forwarded to the accountant for follow-up.

Inventory†

Harrier Peak	20X8	20X7	20X6	20X5	20X4
	$'000s	$'000s	$'000s	$'000s	$'000s
Current inventory	11 826	28 742	28 718	25 374	24 106
Non-current inventory	30 090	10 120	10 708	10 166	9 658
Total inventory	41 916	38 862	39 426	35 540	33 764
Inventory turnover‡	0.76	0.73	0.77	0.76	—
Accounts payable	24 712	14 601	12 241	9 793	9 303

† Note that inventory turnover ratios and balance sheet amounts for inventory and other accounts change over the years. These changes follow audit adjustments to the relevant balances.
‡ Average industry inventory turnover is 1.08 times.

Harrier Peak's inventory turnover is significantly below industry average. This may suggest that sale prices are unattractive and there may be a risk that the inventory is overvalued.

20X8
In the current economic climate, some deterioration in the activity ratios may be expected, so the constancy of the inventory turnover ratio is unexpected. The client has suggested that there was a pick-up in sales in the last quarter that affected the level of inventory as of 30 June 20X8.

It was noted earlier that inventory turnover had remained relatively constant over the three years and increased from 20X7 to 20X8. This is unexpected when the company is building up inventory. This could only happen if sales were also increasing in what is a very tough market. Consideration needs to be given to the possibility of fraudulent overstatement of sales and understatement of inventory.

20X8 Harrier Peak inventory—by segment

		Segment		
	Harrier Peak (whole Company)	Asia	North America	Australia
Inventory turnover	1.02	0.79	1.69	0.93
Current inventory	30 090	3 412	4 085	22 593

Question 1(a)

Audit risk in the Inventory – Accounts payable – Cash system (I-AP-C)
The auditor of Harrier Peak wishes to assess audit risk relating to the I-AP-C. Only detection risk is under the control of the auditor. The auditor's aim, therefore, is to set an appropriate level of detection risk through the design of the audit plan for the 20X8 audit.

Business risk
Based on the information provided above, evaluate **five** business risks in terms of the risk of misstatement of account balances (inventory, payables or cash), classes of transactions (sales, cost of sales or expenses) and key assertions (existence, completeness, etc.). Use the following table for your answer.

Business risk	Account affected	Assertion(s) affected	Explanation

Question 1(b)

Audit risk in the Inventory – Accounts payable – Cash system (I-AP-C)
The auditor of Harrier Peak wishes to assess audit risk relating to the I-AP-C. Only detection risk is under the control of the auditor. The auditor's aim, therefore, is to set an appropriate level of detection risk through the design of the audit plan for the 20X8 audit.

Control risk
Based on the information provided:

(i) Evaluate control risk (high, medium or low) in the payments system for each of inventory, accounts payable and cash. Identify the key assertion(s) at risk and provide an explanation for your risk evaluation. Use the following table for your answer.

Account	Control risk	Assertion at risk	Explanation
Inventory			
Accounts payable			
Cash			

(ii) Identify controls in the I-AP-C that the auditor could rely upon, and accordingly, that should be tested for effectiveness.

....

....

....

....

....

....

....

Question 1(c)

Audit risk in the Inventory – Accounts payable – Cash system (I-AP-C)

The auditor of Harrier Peak wishes to assess audit risk relating to the I-AP-C. Only detection risk is under the control of the auditor. The auditor's aim, therefore, is to set an appropriate level of detection risk through the design of the audit plan for the 20X8 audit.

Detection risk

(i) Considering Harrier Peak's business risk and control risk, determine an appropriate level of detection risk (low, medium or high) for inventory, accounts payable and cash, and justify your choice.

(ii) Determine the audit strategy to be used by the auditor for the I-AP-C (the extent to which the auditor undertakes tests of controls versus substantive testing in the form of analytic review and tests of detail).

Question 2(a)

Audit evidence

The auditor must collect sufficient appropriate evidence to form a conclusion as to whether accounts are materially misstated. This will involve undertaking tests of key controls that the auditor expects to rely upon, substantive tests of details and substantive analytical procedures as determined in the audit strategy.

Tests of controls

For key accounting controls in the I-AP-C (controls over cash purchases and cash payments—see the solution for Question 1(b)), describe tests of those controls the auditor might undertake. For those tests of control that involve sampling, outline your approach to selecting the sample.

Question 2(b)

Audit evidence

The auditor must collect sufficient appropriate evidence to form a conclusion as to whether accounts are materially misstated. This will involve undertaking tests of key controls that the auditor expects to rely upon, substantive tests of details and substantive analytical procedures as determined in the audit strategy.

Substantive tests of detail

Design appropriate substantive tests of detail for inventory and accounts payable. Use the following table for your answer. Tests should be based on appropriate sampling techniques where possible; provide a description of the sampling plan.

Account	Assertion	Test
Inventory	Existence	
	Valuation	
	Rights and obligations	
	Cut-off	
Accounts payable	Completeness	
	Valuation	
	Rights and obligations	

Question 2(c)

Audit evidence

The auditor must collect sufficient appropriate evidence to form a conclusion as to whether accounts are materially misstated. This will involve undertaking tests of key controls that the auditor expects to rely upon, substantive tests of details and substantive analytical procedures as determined in the audit strategy.

Using audit software for substantive testing

The auditor has decided to use an audit software package to test the accounts payable master file at year end. The key assertions to be tested are completeness, cut-off and valuation and allocation.

The accounts payable master file contains the following fields:

- supplier account number;
- supplier name;
- supplier address;
- individual purchases and total purchases for the year to date;
- individual payments and total payments for the year to date; and
- outstanding balance.

Identify tests for the completeness, cut-off and valuation and allocation of accounts payable using the audit software. Complete the following table:

Description of report	Purpose of report	Assertions of interest	Exceptions reported

Extended Response Solutions

Case Study—misstatement risk in inventory, accounts payable and cash

Question 1(a)

Audit risk in the Inventory – Accounts payable – Cash system (I-AP-C)

Business risk

You could have answered the question based on any **five** of the business risks listed here.

Business risk	Account affected	Assertion(s) affected	Explanation
Foreign exchange risk	Inventory	Valuation	Fluctuations in AUD/USD and other forex.
Foreign sales	Inventory, COGS	Cut-off	Less reliable information on sales received from foreign partners.
Foreign and domestic consumer sentiment and GDP	Inventory	Valuation	Wine is a luxury good with a high elasticity of demand.
Low inventory turnover compared to industry	Inventory	Valuation	Turnover may be low because inventory is overpriced.
		Existence	Inventory quantities may be fraudulently overstated.
Business expansion	Accounts payable/expenses	Completeness, presentation and disclosure	Expenses have decreased while the business has expanded. Expenses may be unrecorded or misclassified.

Question 1(b)

Audit risk in the Inventory – Accounts payable – Cash system (I-AP-C)

Control risk

(i) The major concern for the auditor of Harrier Peak is fraudulent overstatement of profit. This could be achieved through the I-AP-C by understating COGS and overstating inventory, or alternatively, by understating accounts payable and expenses. Accordingly the key assertions at risk are inventory existence and valuation, and accounts payable completeness and valuation—in other words, non-existent or overvalued inventory, or unrecorded liabilities.

Account	Control risk	Assertion	Explanation
Inventory	High	Cut-off, existence, valuation	• Lack of control over unusual, particularly year-end, journal entries. • The accounting system appears to relieve inventory before shipment actually takes place. Some cut-off errors are indicated.
Accounts payable	High	Completeness, valuation, existence, presentation and disclosure	• There does not appear to be any control over the completeness of payables. • Controls over long-term/short-term classification of liabilities do not appear to be present. • Valuation controls are present in the payments system (see following).
Cash	Low	Existence, valuation	Some effective controls exist: • Checking purchase requests against budgets. • The matching of the purchase order, receiving report and invoice prior to payment. • Cancellation of documents after recording the liability. • Appropriate segregation of duties (initiation, authorisation, receiving and payment).

(ii) Controls to be tested (as noted in the table above) are as follows:
- Checking purchase requests against budgets.
- The matching of the purchase order, receiving report and invoice prior to payment.
- Cancellation of documents after recording the payable.
- Appropriate segregation of duties (initiation, authorisation, receiving and payment).

Question 1(c)

Audit risk in the Inventory – Accounts payable – Cash system (I-AP-C)

Detection risk

(i) Detection risk is low for inventory and accounts payable because business risk and control risk are both high. Detection risk for cash is medium due to the existence of some key controls—matching and segregation of duties.

The broader control environment has not been assessed here, but the existence of issues identified in prior audits points to weaknesses in the control environment. Certainly, control risk would not be assessed as low in any area. The CEO's incentive plan is not supportive of a good control environment.

(ii) Because detection risk is low, the audit strategy for inventory and accounts payable will be focused on substantive tests of detail. For cash, detection risk is medium, so the audit strategy will include a combination of tests of controls and substantive tests.

Question 2(a)

Tests of controls

Control to be tested	Test
Checking purchase requests against budgets (existence)	Randomly select a sample of cash payments. The sample might be selected from the cash payments journal (e.g. every 50th payment). Review item for evidence of checking against budget by accounting personnel.
The matching of the purchase order, receiving report and invoice prior to payment (valuation)	For the sample selected above, sight evidence that each payment is supported by the three documents (electronic or paper).
Cancellation of documents after recording the payable (existence)	Manual: sight cancellation of documents (stamped or initialled). Electronic: review coding to ensure document duplication is prevented.
Appropriate segregation of duties (initiation, authorisation, receiving and payment) (existence)	Make inquiries of accounting, receiving and management personnel about their duties in relation to purchasing.
Cut-off	An additional test should be performed by checking that accruals are made as appropriate for goods received near the end of the year.

Note that substantive tests of detail are often combined with tests of control. For example, the first control test above requires a sample of cash payments to be selected. This sample could be used at the same time for substantive testing. This would be done by extending the control test. In addition to looking for evidence of the control, the auditor would also check that the amount of the purchase did not exceed the budgetary allowance. The testing of the dollar amount makes this a substantive test of detail.

The same point could be made about the second test, to make this a substantive test of detail: the auditor would need to agree the dollar amounts on the three documents.

Question 2(b)

Substantive tests of detail

Account	Assertion	Test
Inventory	Existence	Sample: item drawn randomly from the inventory sub-ledger (e.g. every 10th inventory item). Test the item (# of bottles) by counting the items in the warehouse, preferably at the annual count. Sight documentation or seek confirmation where wine is in the custody of others.
	Valuation	For the sample above, test the valuation by comparing the recorded inventory value with evidence of the market value from recently completed sales. Where no recent sales exist, consider obsolescence.
	Rights and obligations	Where inventory is held by others, review contract terms or other documentary evidence, or consider confirmation to verify ownership.
	Cut-off	Examine a sample of sales around the year end to ensure that inventory relief and the sale (and COGS and accounts receivable) are recorded at the same time.
Accounts payable	Completeness	Select a sample that includes current and past suppliers, including some with zero balances. Verify the existence and address of the supplier with reference to external sources (the web or phone book). Mail a positive confirmation letter to the supplier asking them to nominate the amount due from Harrier Peak at year end.
	Valuation	The confirmation letters noted above also provide assurance regarding valuation. The sample of payments selected for the control test (see the solution for Question 2(a)) would provide evidence of valuation if the amounts on the three documents were to be agreed.
	Rights and obligations	Obligations are established by the three documents mentioned above: the purchase order, the receiving report and the invoice. Ensure that the documents are all created by, or addressed to, Harrier Peak.

Question 2(c)

Using audit software for testing

Description of report	Purpose	Assertion	Exceptions reported
Review of matching exceptions re. the purchase order, receiving report and invoice.	Test of matching control; substantive test of balances.	Valuation, existence, completeness	Instances where the totals on the purchase order, the receiving report and the invoice do not match.
Verify total of sub-ledger.	Substantive test. Reconcile sub-ledger and general ledger.	Valuation	Where the auditor's sub-ledger total did not agree with the client's general ledger.
Compare file of confirmation responses, with Harrier Peak payables sub-ledger.	Identification of under- or over-valued creditors.	Existence, completeness, valuation, obligations	Where supplier confirmation and payables sub-ledger account disagree.
Match cash payments subsequent to year-end with year-end payable accruals.	Ensure all liabilities are accrued.	Cut-off, completeness	Payment for which no accrual exists.