****** ESSAY QUESTIONS ******

1. (a) [10%] What is the "Generally Accepted Auditing Standards" (GAAS)? Do specifically state elements that constitute the GAAS.

   (b) [7%] What are new changes in the revised Statement of Auditing Standard No. 1 (1997) of ROC's Auditing Standard Board, the Accounting Research and Development Foundation?

   (c) [7%] How the changes in (b) would affect the auditor's reports?

2. (a) [5%] The R. O. C. government plans to use outside computer providers for her computer needs. Many corporations also use outside service bureaus to prepare employees' payrolls. If you are the user auditor (of the entity using outside computer services), should you take consideration of the internal control structure of outside computer service providers when you plan the audit engagement for the user entity? State the reasons.

   (b) [10%] List at least five factors you should consider in order to determine the extent you should understand outside computer providers' internal control structures when planning your audit on the user entity's financial statements.

   (c) [10%] State at lease five possible ways that make you understanding outside computer providers' internal control structure.

****** OBJECTIVE QUESTIONS ******

Choose the best (one) answer for questions 3-36. ([1.5%] each)

3. May a CPA hire for the CPA's public accounting firm a non-CPA systems analyst who specializes in developing computer systems?
   a. Yes, provided the CPA is qualified to perform each of the specialist's tasks.
   b. Yes, provided the CPA is able to supervise the specialist and evaluate the specialist's end product.
   c. No, because non-CPA professionals are not permitted to be associated with CPA firms in public practice.
   d. No, because developing computer systems is not recognized as a service performed by public accountants.

4. An auditor who discovers that client employees have committed an illegal act that has a material effect on the client's financial statements most likely would withdraw from the engagement if
   a. The illegal act is a violation of generally accepted accounting principles.
   b. The client does not take the remedial action that the auditor considers necessary.
   c. The illegal act was committed during a prior year that was not audited.
   d. The auditor has already assessed control risk at the maximum level.

5. DMO Enterprises, Inc., engaged the accounting firm of Martin, Seals, and Anderson to perform its annual audit. The firm performed the audit in a competent, nonnegligent manner and billed DMO for $16,000, the agreed-upon fee. Shortly after delivery of the audited financial statements, Hightower, the assistant controller, disappeared, taking with him $28,000 of DMO's funds. It was then discovered that Hightower had been engaged in a highly sophisticated, novel defalcation scheme during the past year. He had previously embezzled $35,000 of DMO's funds. DMO has refused to pay the accounting firm's fee and is seeking to recover the $63,000 that was stolen by Hightower. Which of the following is correct?
   a. The accountants cannot recover their fee and are liable for $63,000.
   b. The accountants are entitled to collect their fee and are not liable for $63,000.
   c. DMO is entitled to rescind the audit contract and thus is not liable for the $16,000 fee, but it cannot recover damages.
   d. DMO is entitled to recover the $28,000 defalcation, and is not liable for the $16,000 fee.

6. Mix and Associates, CPAs, issued an unqualified opinion on the financial statements of Glass Corp. for the year ended December 31, 1996. It was determined later that Glass's treasurer had embezzled $300,000 from Glass during 1996. Glass sued Mix because of Mix's failure to discover the embezzlement. Mix was unaware of the embezzlement. Which of the following is Mix's best defense?
   a. The audit was performed in accordance with GAAS.
   b. The treasurer was Glass's agent and, therefore, Glass was responsible for preventing the embezzlement.
   c. The financial statements were presented in conformity with GAAP.
   d. Mix had no actual knowledge of the embezzlement.

7. As a result of analytical procedures, the independent auditor determines that the gross profit has declined from 30% in the preceding year to 20% in the current year. The auditor should
   a. Document management's intentions with respect to plans for reversing this trend.
   b. Evaluate management's performance in causing this decline.
   c. Require footnote disclosure.
   d. Consider the possibility of an error in the financial statements.

8. The auditor will most likely perform extensive tests for possible understatement of
   a. Revenues.
   b. Assets.
   c. Liabilities.
   d. Capital.

9. In testing the existence assertion for an asset, an auditor ordinarily works from the
   a. Financial statements to the potentially unrecorded items.
   b. Potentially unrecorded items to the financial statements.
   c. Accounting records to the supporting evidence.
   d. Supporting evidence to the accounting records.

10. In considering materiality for planning purposes, an auditor believes that misstatements aggregating $10,000 would have a material effect on an entity's income statement, but that misstatements would have to aggregate $20,000 to materially affect the balance sheet. Ordinarily, it would be appropriate to design auditing procedures that would be expected to detect misstatements that aggregate
   a. $10,000.
   b. $15,000.
   c. $20,000.
   d. $30,000.

11. The risk that an auditor will conclude, based on substantive tests, that a material error does not exist in an account balance when, in fact, such error does exist is referred to as
a. Sampling risk.
b. Detection risk.
c. Nonsampling risk.
d. Inherent risk.

12. Inherent risk and control risk differ from detection risk in that inherent risk and control risk are
a. Elements of audit risk, while detection risk is not.
b. Changed at the auditor's discretion, while detection risk is not.
c. Considered at the individual account balance level, while detection risk is not.
d. Functions of the client and its environment, while detection risk is not.

13. Which of the following audit risk components may be assessed in nonquantitative terms?

	Control risk	*Detection risk*	*Inherent risk*
a.	Yes	Yes	Yes
b.	No	Yes	Yes
c.	Yes	Yes	No
d.	Yes	No	Yes

14. On the basis of audit evidence gathered and evaluated, an auditor decides to increase the assessed level of control risk from that originally planned. To achieve an overall audit risk level that is substantially the same as the planned audit risk level, the auditor would
a. Increase inherent risk.
b. Increase materiality levels.
c. Decrease substantive testing.
d. Decrease detection risk.

15. Which of the following internal control activities most likely addresses the completeness assertion for inventory?
a. Work-in-process account is periodically reconciled with subsidiary records.
b. Employees responsible for custody of finished goods do *not* perform the receiving function.
c. Receiving reports are prenumbered and periodically reconciled.
d. There is a separation of duties between payroll department and inventory accounting personnel.

16. Which of the following controls most likely would help ensure that all credit sales transactions of an entity were recorded?
a. The billing department supervisor sends copies of approved sales orders to the credit department for comparison to authorized credit limits and current customer account balances.
b. The accounting department supervisor independently reconciles the accounts receivable subsidiary ledger to the accounts receivable control account monthly.
c. The accounting department supervisor controls the mailing of monthly statements to customers and investigates any differences reported by customers.
d. The billing department supervisor matches prenumbered shipping documents with entries in the sales journal.

17. Which of the following controls would an entity most likely use in safeguarding against the loss of marketable securities?
    a. An independent trust company that has no direct contact with the employees who have record-keeping responsibilities has possession of the securities.
    b. The internal auditor verifies the marketable securities in the entity's safe each year on the balance sheet date.
    c. The independent auditor traces all purchases and sales of marketable securities through the subsidiary ledgers to the general ledger.
    d. A designated member of the board of directors controls the securities in a bank safe-deposit box.

18. After obtaining an understanding of an entity's internal control system and assessing control risk, an auditor next may
    a. Perform tests of controls to verify management's assertions that are embodied in the financial statements.
    b. Consider whether evidential matter is available to support a further reduction in the assessed level of control risk.
    c. Apply analytical procedures as substantive tests to validate the assessed level of control risk.
    d. Evaluate whether the internal control system policies and procedures detected material misstatements in the financial statements.

19. A weakness in internal control over recording retirements of equipment may cause an auditor to
    a. Trace additions to the "other assets" account to search for equipment that is still on hand but no longer being used.
    b. Select certain items of equipment from the accounting records and locate them in the plant.
    c. Inspect certain items of equipment in the plant and trace those items to the accounting records.
    d. Review the subsidiary ledger to ascertain whether depreciation was taken on each item of equipment during the year.

20. An auditor most likely would review an entity's periodic accounting for the numerical sequence of shipping documents and invoices to support management's financial statement assertion of
    a. Existence or occurrence.
    b. Rights and obligations.
    c. Valuation or allocation.
    d. Completeness.

21. An auditor desired to test credit approval on 10,000 sales invoices processed during the year. The auditor designed a statistical sample that would provide a 1 percent risk of assessing control risk too low (99% confidence) that not more than 7 percent of the sales invoices lacked approval. The auditor estimated from previous experience that about 2½% of the sales invoices lacked approval. A sample of 200 invoices was examined; 7 of them were lacking approval. The auditor then determined the upper occurrence limit to be 8%.

In the evaluation of this sample, the auditor decided to increase the level of the preliminary assessment of control risk because the
a. Tolerable rate (7%) was less than the achieved upper occurrence limit (8%).
b. Expected occurrence rate (7%) was more than the percentage of errors in the sample (3½%).
c. Achieved upper occurrence limit (8 percent) was more than the percentage of errors in the sample (3½%).
d. Expected occurrence rate (2½%) was less than the tolerable rate (7%).

22. An auditor plans to examine a sample of 20 checks for countersignatures as prescribed by the client's internal control procedures. One of the checks in the chosen sample of 20 cannot be found. The auditor should consider the reasons for this limitation and
a. Evaluate the results as if the sample size had been 19.
b. Treat the missing check as an error for the purpose of evaluating the sample.
c. Treat the missing check in the same manner in which the majority of the other 19 checks are treated, that is, as countersigned or not.
d. Choose another check to replace the missing check in the sample.

23. The diagram below depicts the auditor's estimated maximum deviation rate compared with the tolerable rate, and also depicts the true population deviation rate compared with the tolerable rate

Auditor's Estimate Based On Sample Results	True State Of Population: *Deviation rate is less than tolerable rate*	True State Of Population: *Deviation rate exceeds tolerable rate*
Maximum deviation rate is less than tolerable rate	I	III
Maximum deviation rate exceeds tolerable rate	II	IV

As a result of tests of controls, the auditor assesses control risk higher than necessary, and thereby increases substantive testing. This is illustrated by situation
a. I.
b. II.
c. III.
d. IV.

24. What is an auditor's evaluation of a statistical sample for attributes when a test of 50 documents results in 3 deviations, if the tolerable occurrence rate is 7%, the expected occurrence rate is 5%, and the allowance for sampling risk is 2%?
a. Modify the planned assessed level of control risk, because the tolerable rate plus the allowance for sampling risk exceeds the expected population deviation rate.
b. Accept the sample results as support for the planned assessed level of control risk, because the sample deviation rate plus the allowance for sampling risk exceeds the tolerable rate.
c. Accept the sample results as support for the planned assessed level of control risk, because the tolerable rate less the allowance for sampling risk equals the expected population deviation rate.
d. Modify the planned assessed level of control risk, because the sample deviation rate plus the allowance for sampling risk exceeds the tolerable rate.

25. In a probability proportional to size sample with a sampling interval of $10,000, an auditor discovered that a selected account receivable with a recorded amount of $5,000 had an audit amount of $2,000. The projected error of this sample was
a. $3,000.
b. $4,000.
c. $6,000.
d. $8,000.

26. Which of the following most likely would be an advantage in using classical variables sampling rather than probability proportional to size (PPS) sampling?
   a. An estimate of the standard deviation of the population's recorded amounts is not required.
   b. The auditor rarely needs the assistance of a computer program to design an efficient sample.
   c. Inclusion of zero and negative balances generally does not require special design considerations.
   d. Any amount that is individually significant is automatically identified and selected.

27. Which of the following statements ordinarily is included among the written client representations obtained by the auditor?
   a. Management acknowledges that there are no material weaknesses in internal control.
   b. Sufficient evidential matter has been made available to permit the issuance of an unqualified opinion.
   c. Compensating balances and other arrangements involving restrictions on cash balances have been disclosed.
   d. Management acknowledges responsibility for illegal actions committed by employees.

28. An auditor's program to examine long-term debt most likely would include steps that required
   a. Comparing the carrying amount of the debt to its year-end market value.
   b. Correlating interest expense recorded for the period with outstanding debt.
   c. Verifying the existence of the holders of the debt by direct confirmation.
   d. Inspecting the accounts payable subsidiary ledger for unrecorded long-term debt.

29. To satisfy the valuation assertion when auditing an investment accounted for by the equity method, an auditor most likely would
   a. Inspect the stock certificates evidencing the investment.
   b. Examine the audited financial statements of the investee company.
   c. Review the broker's advice or canceled check for the investment's acquisition.
   d. Obtain market quotations from financial newspapers or periodicals.

30. An auditor should request that an audit client send a letter of inquiry to those attorneys who have been consulted concerning litigation, claims, or assessments. The primary reason for this request is to provide
   a. The opinion of a specialist as to whether loss contingencies are possible, probable, or remote.
   b. A description of litigation, claims, and assessments that have a reasonable possibility of unfavorable outcomes.
   c. An objective appraisal of management's policies and procedures adopted for identifying and evaluating legal matters.
   d. The corroboration of the information furnished by management concerning litigation, claims, and assessments.

31. After issuing a report, an auditor has no obligation to make continuing inquiries or perform other procedures concerning the audited financial statements, unless
   a. Information that existed at the report date and may affect the report comes to the auditor's attention.
   b. Management of the entity requests the auditor to reissue the auditor's report.
   c. Information about an event that occurred after the end of field work comes to the auditor's attention.
   d. Final determinations or resolutions are made of contingencies that had been disclosed in the financial statements.

32. In which of the following situations would a principal auditor be *least* likely to make reference to another auditor who audited a subsidiary of the entity?
   a. The other auditor was retained by the principal auditor and the work was performed under the principal auditor's guidance and control.
   b. The principal auditor finds it impracticable to review the other auditor's work or otherwise be satisfied as to the other auditor's work.
   c. The financial statements audited by the other auditor are material to the consolidated financial statements covered by the principal auditor's opinion.
   d. The principal auditor is unable to be satisfied as to the independence and professional reputation of the other auditor.

33. When an auditor expresses an adverse opinion, the opinion paragraph should include
   a. The principal effects of the departure from generally accepted accounting principles.
   b. A direct reference to a separate paragraph disclosing the basis for the opinion.
   c. The substantive reasons for the financial statements being misleading.
   d. A description of the uncertainty or scope limitation that prevents an unqualified opinion.

34. A limitation on the scope of an audit sufficient to preclude an unqualified opinion will usually result when management
   a. Is unable to obtain audited financial statements supporting the entity's investment in a foreign subsidiary.
   b. Refuses to disclose in the notes to the financial statements related-party transactions authorized by the board of directors.
   c. Does not sign an engagement letter specifying the responsibilities of both the entity and the auditor.
   d. Fails to correct a reportable condition communicated to the audit committee during the prior year's audit.

35. Which of the following procedures most likely would be included in a review engagement of a nonpublic entity?
   a. Preparing a bank transfer schedule.
   b. Inquiring about related-party transactions.
   c. Assessing the internal control system.
   d. Performing cutoff tests on sales and purchases transactions.

36. Must a CPA in public practice be independent in fact and appearance when providing the following services?

	Compilation of personal financial statements	*Preparation of a tax return*	*Compilation of a financial forecast*
a.	No	No	No
b.	No	No	Yes
c.	Yes	No	No
d.	No	Yes	No