

FINAL EXAM FROM MPF_AAUD AUDITING

Name, Surname	Number of points	% of correct answers

TOTAL NUMBER OF POINTS – 60 points

Part I. Multiple choice questions, only one correct answer is possible, total number of points - 20 points

1. An auditor concludes that there is substantial doubt about an entity’s ability to continue as a going concern for a reasonable period of time. If the entity’s financial statements adequately disclose its financial difficulties, the auditor’s report is required to include an explanatory paragraph that specifically uses the phrase(s):

“Reasonable period of time , not to exceed one year”	“Going concern”
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|----|-----|-----|
| a) | Yes | Yes |
| b) | Yes | No |
| c) | No | Yes |
| d) | No | No |

2. Which of the following statements best describes an auditor’s responsibility to detect errors and fraud?
- An auditor should design an audit to provide reasonable assurance of detecting errors and fraud that are material to the financial statements.
 - An auditor is responsible to detect material errors, but has no responsibility to detect fraud that is concealed through employee collusion or management override of internal control.
 - An auditor has no responsibility to detect errors and fraud unless analytical procedures or tests of transactions identify conditions causing a reasonably prudent auditor to suspect that the financial statements were materially misstated.
 - An auditor has no responsibility to detect errors and fraud because an auditor is not an insurer and an audit does not constitute a guarantee.
3. An auditor strives to achieve independence in appearance to:
- Appear to an independent third party not to have compromised their integrity.
 - Become independent in fact.
 - Comply with the international auditing standards of fieldwork.
 - Evaluation of all matters of continuing accounting significance.
4. According to ISA 200, the risk of material misstatement consists of which components?
- Inherent risk, control risk and detection risk.
 - Control risk and detection risk.
 - Inherent risk and detection risk.
 - Inherent risk and control risk.
5. ISA 200 contains the following definition: 'An attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence.' What does this define?

- a) Professional judgment.
 - b) Professional competence.
 - c) Professional behavior.
 - d) Professional skepticism.
6. According to ISA 200, what is the purpose of an audit?
- a) To help management achieve its responsibility for the presentation of financial statements.
 - b) To report to shareholders on the truth and fairness of the financial statements.
 - c) To enhance the degree of confidence of the intended users of the financial statements.
 - d) To ensure the financial statements are free from error.
7. Which parts of an ISA need to be understood by the auditor? (i) Objectives (ii) Requirements (iii) Introductory material (iv) Application and explanatory material:
- a) All of them.
 - b) (i) (ii) and (iv).
 - c) (i), (ii) and (iii).
 - d) (i) and (ii).
8. The IAASB appreciates that the auditor of smaller entities may have specific concerns. How are these concerns addressed?
- a) The application material contains separate sections dealing with considerations specific to smaller entities.
 - b) ISAs do not have to be followed in the audit of smaller entities.
 - c) The auditor can agree with management of smaller entities to ignore ISA requirements, as long as this is disclosed in the auditor's report.
 - d) There are a separate set of requirements relevant to the audit of smaller entities.
9. ISA 200 requires the auditor to comply with ethical requirements. Which ethical principle is specifically referred to in this requirement?
- a) Objectivity.
 - b) Confidentiality.
 - c) Independence.
 - d) Competence.
10. ISA 200 requires that the auditor obtains what level of assurance about whether the financial statements are free of material misstatement?
- a) Absolute.
 - b) Reasonable.
 - c) Moderate.
 - d) Medium.
11. Which of the following statements is correct concerning an auditor's assessment of control risk?
- a) Assessing control risk may be performed concurrently during an audit with obtaining an understanding of the entity's internal control.
 - b) Evidence about the operation of internal control in prior audits may not be considered during the current year's assessment of control risk.

- c) The basis for an auditor's conclusions about the assessed level of control risk need not be documented unless control risk is assessed at the maximum.
 - d) The lower the assessed level of control risk, the less assurance the evidence must provide that the control procedures are operating effectively.
12. Proper segregation of functional responsibilities calls for separation of the functions of:
- a) Authorization, execution, and payment.
 - b) Authorization, recording, and custody.
 - c) Custody, execution, and reporting.
 - d) Authorization, payment, and recording.
13. Which of the following procedures most likely would provide an auditor with evidence about whether an entity's internal control activities are suitably designed to prevent or detect material misstatements?
- a) Re-performing the activities for a sample of transactions.
 - b) Performing analytical procedures using data aggregated at a high level.
 - c) Vouching a sample of transactions directly related to the activities.
 - d) Observing the entity's personnel applying the activities.
14. Control risk should be assessed in terms of:
- a) Special controls.
 - b) Types of potential fraud.
 - c) Financial statement assertions.
 - d) Control environment factors.
15. When planning an audit, the auditor's knowledge about the design of relevant internal controls should be used to:
- a) Assess the efficiency of internal controls over operations.
 - b) Identify the types of potential misstatements that could occur.
 - c) Report the assessed level of control risk in work papers.
 - d) Evaluate which controls are circumvented due to collusion.
16. Which of the following questions would an auditor most likely include on an internal control questionnaire for notes payable?
- a) Are assets that collateralize notes payable critically needed for the entity's continued existence?
 - b) Are two or more authorized signatures required on checks that repay notes payable?
 - c) Are the proceeds from notes payable used for the purchase of noncurrent assets?
 - d) Does the board of directors authorize direct borrowings on notes payable?
17. The auditor's primary reason for assessing control risk is that control risk assessment:
- a) Affects the level of detection risk that the auditor may accept.
 - b) Shows the auditor where inherent risk may be the greatest.
 - c) Is relevant to the auditor's understanding of the control environment.
 - d) Provides assurance that the materiality level set by the auditor is appropriate.
18. An auditor is most likely to assess control risk at the maximum if the payroll department supervisor is responsible for:
- a) Examining authorization forms for new employees.

- b) Comparing payroll registers with original batch transmittal data.
 - c) Authorizing payroll rate changes for all employees.
 - d) Hiring all subordinate payroll departments.
19. In determining the effectiveness of an entity's internal controls relating to the existence or occurrence assertion for payroll transactions, an auditor most likely would inquire about and:
- a) Observe the segregation of duties concerning personnel responsibilities and payroll disbursement.
 - b) Inspect evidence of accounting for prenumbered payroll checks.
 - c) Recompute the payroll deductions for employee fringe benefits.
 - d) Verify the preparation of the monthly payroll account bank reconciliation.
20. An auditor wishes to perform tests of controls on cash disbursements procedures. If the controls leave no audit trail of documentary evidence, the auditor most likely will test the procedures by:
- a) Inquiry and analytical procedures.
 - b) Confirmation and observation.
 - c) Analytical procedures and confirmation.
 - d) Observation and inquiry.

Part II. Case study, total number of points (40 points)

Read the case Madoff Investment Securities, LLC. and answer the question given below:

1. Think about audit evidence (8 points = 4 questions x 2 point)
 - a) What is audit evidence? Give brief definition/explanation.
 - b) Which two characteristics determine the quality of audit evidence? How does the quantity of audit evidence affect the audit process?
 - c) What is the connection between the quality, quantity and cost of audit evidence?
 - d) What is audit sample? Give brief definition and name two major approaches used by auditors to sampling. What is the connection between audit sampling and audit data mining?
2. Name the parties, which, you believe, are responsible for successful operating of the Madoff fraudulent scheme for almost four decades. **(4 points)**
3. Identify the ethical rules of professional conduct which were violated by David Friebling from Friebling & Horowitz when he had been conducting audits of Madoff Investment Securities for almost four decades? **(4 points)**
4. Name and briefly explain four major indicators proposed by Markopolos suggesting that Bernard Madoff was perpetrating a massive fraud on his clients. **(4 points)**
5. How do you think why the SEC did not studied the proposed by Markopolos red flags report regarding Madoff's fraud with due care? Can "deep-pocket theory" be applied to Madoff's investment fund (note: "deep-pocket theory" states that big companies value their image and reputation and that is why they avoid suspicions deals which may lead to numerous litigations which can cost tens of millions of dollars for these companies)? Was it a failure of the regulatory oversight function for the US stock market? **(4 points)**
6. Name and briefly explain three major factors which accounted for Madoff's ability to run his massive fraudulent scheme successfully for almost four decades. **(4 points)**
7. In 2001 *Barron's* reported that some of the Madoff firm's largest investment funds had never experienced a losing year despite significant stock market declines in several individual years. How such long-term outstanding performance of Madoff's investment funds fit with efficient market hypothesis (note: under efficient market hypothesis no individual or institutional investor can earn extra returns in the long-term period). **(4 points)**
8. Name public accounting firm(s) which were latter named as defendant(s) in civil lawsuit(s) triggered by the Madoff fraud. Briefly explain the substance of these litigations. **(4 points)**
9. What reforms in regulation of asset management industry were suggested by the SEC in the aftermath of the Madoff fraud? **(4 points)**