

**MIDTERM TEST FROM MPF\_AAUD AUDITING**

Name, Surname	Number of points	% of correct answers

**TOTAL NUMBER OF POINTS – 20 points**

**Part I. Multiple choice questions with one correct answer, total number of points – 5**

1. 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).
  
2. Which of the following statements best describes an auditor's responsibility to detect errors and fraud?
  - a) An auditor should design an audit to provide reasonable assurance of detecting errors and fraud that are material to the financial statements.
  - b) 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.
  - c) 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.
  - d) 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. 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.
  
4. The auditor with final responsibility for an engagement and one of the assistants has a difference of opinion about the client's application of an accounting method. If the assistant believes it is necessary to be disassociated with the matter's resolution, the audit firm's procedures should enable the assistant to:
  - a) Refer the disagreement to IFAC's Quality Review Committee.
  - b) Review the conflict with a senior partner in the audit firm.
  - c) Discuss the disagreement with the entity's management or its audit committee.
  
5. Before accepting an audit engagement a proposed (successor) auditor should make specific inquiries of the existing (predecessor) auditor regarding the existing auditor's:
  - a) Opinion of any subsequent events occurring since the existing auditor's audit report was issued.
  - b) Understanding as to the reasons for the change of auditors.
  - c) Awareness of the consistency in the application of accounting principles between periods.
  - d) Evaluation of all matters of continuing accounting significance.

6. Which of the following is NOT a responsibility of the auditor?
  - a) To provide an opinion on the truth and fairness of the financial statements.
  - b) To conduct an audit in accordance with International Standards on Auditing.
  - c) To express an opinion on the company's going concern status.
  
7. According to ISA 200, the risk of material misstatement consists of which components?
  - a) Inherent risk, control risk and detection risk.
  - b) Control risk and detection risk.
  - c) Inherent risk and detection risk.
  - d) Inherent risk and control risk.
  
8. Which of the following statements is correct about independence?
  - a) Independence is potentially affected by self-interest, self-review, advocacy, familiarity and intimidation threats.
  - b) Independence is not an element that is considered in the audit process.
  - c) Independence is immaterial to the financial statements.
  - d) Independence is not a requirement of IFAC's Code of Ethics.
  
9. 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.
  
10. 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.

**Part II. Case study, total number of points – 15**

Read the case “ZZZZ Best Company, Inc.” and answer the question given below (10 points = 8 questions x 2.5 points)

1. Think about client acceptance (**7 points** = 4 questions x 0.5 points)
  - a) What is client acceptance? Give brief definition/explanation in terms of 4-stage audit process, explain its connection with other stages. (2 points)
  - b) What are the two objectives of auditor during acceptance stage? (1 point)
  - c) What sources of information does auditor use for examination of the proposed client and deciding about its acceptance? Name the major three sources. (2 points)
  - d) Why does auditor hire an expert for some audit engagements? If an expert is invited, how it will effect auditor’s report (opinion)? (2 points)
2. Briefly define the so-called “Ponzi scheme” as it relates to fraud scandals of public companies (e.g. ZZZZ Best Company, Inc., Madoff Investment Securities, LLC.) which happened in recent years? (**1 point**)
3. Name the parties which, you believe, are responsible for successful operating of the Minkow’s fraudulent scheme and transforming his small door-to-door carpet cleaning business into \$100-million-of-profit generating public company. (**1 point**)
4. What is the purpose of predecessor-successor auditor communications? Which party – the predecessor or successor – has the responsibility for initiating these communications? Did Ernst & Whinney initiated communication with George Greenspan during and after accepting ZZZZ Best as their new client? (**1 point**)
5. Name four services, which under engagement letter Ernst & Whinney obliged to provide for ZZZZ Best? Were they provided in full extent? (**1 point**)
6. Did the confidentiality agreement that Minkow required Ernst & Whinney to sign improperly limit the scope of the ZZZZ Best audit? If yes, how do you think, why Ernst & Whinney accepted it? (**1 point**)
7. Ernst & Whinney never issued an audit opinion on financial statements of ZZZZ Best but did issue a review report on the company’s quarterly statements for the three months ended July 31, 1986. How does a review differ from an audit, particularly in terms of the level of assurance implied by the auditor’s report? (**1 point**)
8. How do you think how could Ernst & Whinney overlook ten red flags while examining ZZZZ Best’s financial statements and which were latter discovered by SEC investigators? (**1 point**)
9. What reforms in regulation of audit of public companies were suggested (should be) by the SEC in the aftermath of ZZZZ Best fraud (Hint: how much time did it take former auditor to fill and publish an exhibit letter to form 8-K during ZZZZ Best’s times?) (**1 point**)