

CPA REVIEW SCHOOL OF THE PHILIPPINES
Manila

AUDITING THEORY

Overview of Auditing

Related PSAs : PSA 100, 120, 200 and 610

1. Certain fundamental beliefs called "postulates" underlie auditing theory. Which of the following is not a postulate of auditing?
 - a. No long-term conflict exists between the auditor and the management of the enterprise under audit.
 - b. Economic assertions can be verified.
 - c. The auditor acts exclusively as an auditor.
 - d. **An audit has a benefit only to the owners.**
2. In all cases, audit reports must
 - a. Be signed by the individual who performed the audit procedures.
 - b. Certify the accuracy of the quantitative information which was audited.
 - c. Communicate the auditor's finding to the general public.
 - d. **Inform readers of the degree of correspondence between the quantifiable information and the established criteria.**
3. The auditor communicates the results of his or her work through the medium of the
 - a. Engagement letter
 - b. **Audit report**
 - c. Management letter.
 - d. Financial statements.
4. As used in auditing, which of the following statements best describes "assertions"?
 - a. Assertions are the representations of management as to the reliability of the information system.
 - b. Assertions are the auditor's findings to be communicated in the audit report.
 - c. **Assertions are the representations of management as to the fairness of the financial statements.**
 - d. Assertions are found only in the footnotes to the financial statements.
5. The expertise that distinguishes auditors from accountants is in the
 - a. Ability to interpret generally accepted accounting principles.
 - b. Requirement to possess education beyond the Bachelor's degree.
 - c. **Accumulation and interpretation of evidence.**
 - d. Ability to interpret ASC Statements.
6. The framework for auditing and related services as addressed by PSA excludes
 - a. Review
 - b. **Tax services**
 - c. Compilation
 - d. Agreed upon procedure
7. It refers to the level of auditor's satisfaction as to the reliability of an assertion being made by one party for use by another party.
 - a. Confidence level
 - b. Reasonableness level
 - c. **Assurance level**
 - d. Tolerable level
8. Indicate the level of assurance provided by audit and related services.

	<u>a</u>	<u>b</u>	<u>c</u>	<u>d</u>
• Audit	High	High	Negative	Absolute
• Review	Moderate	None	Moderate	High
• Agreed-upon procedures	None	None	None	Limited
• Compilation	None	None	None	None
9. Which of the following is true of the report based on agreed-upon-procedures?
 - a. **The report is restricted to those parties who have agreed to the procedures to be performed.**
 - b. The CPA provides the recipients of the report limited assurance as to reasonableness of the assertion(s) presented in the financial information.
 - c. The report states that the auditor has not recognized any basis that requires revision of financial statements.
 - d. The report should state that the procedures performed are limited to analytical procedures and inquiry.

10. Which of the following is an objective of a review engagement?
 - a. Expressing a positive opinion that the financial information is presented in conformity with generally accepted accounting principles.
 - b. Expressing a limited assurance to users who have agreed as to procedures that will be performed by the CPA.
 - c. Reporting whether material modifications should be made to such financial statements to make them conform with generally accepted accounting principles.
 - d. Reporting that the financial statements, in all materials respects, fairly present the financial position and operating results of the client.
11. According to Philippine Standard on Auditing, the procedures employed in doing compilation are:
 - a. Designed to enable the accountant to express a limited assurance.
 - b. Designed to enable the accountant to express a negative assurance.
 - c. Not designed to enable the accountant to express any form of assurance.
 - d. Less extensive than review procedures but more extensive than agreed-upon procedures.
12. Any services in which the CPA firm issues a written communication that express a conclusion with respect to the reliability of a written assertion that is the responsibility of another party is a (n)
 - a. Accounting and bookkeeping service
 - b. Management advisory service
 - c. Attestation service
 - d. Tax service
13. The three types of attestation services are:
 - a. Audits, review, and compilations
 - b. Audits, compilations, and other attestation services
 - c. Reviews, compilations, and other attestation services
 - d. Audits, reviews, and other attestation services
14. Which of the following is not primary category of attestation report?
 - a. Compilation report
 - b. Review report
 - c. Audit report
 - d. Special audit report based on a basis of accounting other than generally accepted accounting principles.
15. The primary goal of the CPA in performing the attest function is to
 - a. Detect fraud
 - b. Examine individual transactions so that the auditor may certify as to their validity
 - c. Determine whether the client's assertions are fairly stated
 - d. Assure the consistent application of correct accounting procedures
16. Which of the following criteria is unique to the independent auditor's attest function?
 - a. General competence
 - b. Familiarity with the particular industry of each client
 - c. Due professional care
 - d. Independence
17. Assurance engagement
 - a. Is an engagement in which a practitioner is engaged to issue, or does issue, a written communication that expresses a conclusion about the reliability of a written assertion that is the responsibility of another party.
 - b. Is a systematic process of objectively obtaining and evaluating evidence regarding assertions about economic actions and events to ascertain the degree of correspondence between those assertions and established criteria and communicating the results to interested users.
 - c. Is an engagement in which the auditor provides a moderate level of assurance that the information subject to the engagement is free of material misstatement.
 - d. Is an engagement intended to enhance the credibility of information about a subject matter by evaluating whether the subject matter conforms in all material respects with suitable criteria, thereby improving the likelihood that the information will meet the needs of an intended user.
18. The single feature that most clearly distinguishes auditing, attestation, and assurance is
 - a. Type of service.
 - b. Training required to perform the service
 - c. Scope of services.
 - d. CPA's approach to the service

19. Identify the following as financial audit (FA), compliance audit (CA), and operational audit (OA).
 - A supervisor is not carrying out his assigned responsibilities.
 - A company's tax return does not conform to income tax laws and regulations.
 - A municipality's financial statements correctly show actual cash receipts and disbursements.
 - A company's receiving department is inefficient.
 - a. CA, CA, FA, OA
 - b. OA, CA, CA, OA
 - c. OA, CA, FA, OA
 - d. CA, CA, FA, CA
20. The criteria for evaluating quantitative information vary. For example, in the audit of historical financial statements by CPA firms, the criteria are usually
 - a. Generally accepted auditing standards.
 - b. Generally accepted accounting principles.
 - c. Regulations of the Internal Revenue Service.
 - d. Regulations of the Securities and Exchange Commission.
21. Which of the following types of audit uses as its criteria laws and regulations?
 - a. Operational audit
 - b. Compliance audit
 - c. Financial statement audit
 - d. Financial audit
22. An operational audit is designed to
 - a. Assess the efficiency and effectiveness of management's operating procedures
 - b. Assess the presentation of management's financial statements in accordance with generally accepted accounting principles
 - c. Determine whether management has complied with applicable laws and regulations
 - d. Determine whether the audit committee of the board of directors is effectively discharging its responsibility to oversee management's operations
23. A review of any part of an organization's procedures and methods for the purpose of evaluating efficiency and effectiveness is classified as a (n)
 - a. Audit of financial statements
 - b. Compliance audit
 - c. Operational audit
 - d. Production audit
24. Which one of the following is more difficult to evaluate objectively?
 - a. Efficiency and effectiveness of operations.
 - b. Compliance with government regulations.
 - c. Presentation of financial statements in accordance with generally accepted accounting principles.
 - d. All three of the above are equally difficult..
25. Independent auditing can best be described as a
 - a. Branch of accounting
 - b. Discipline that attests to the results of accounting and other operations and data
 - c. Professional activity that measures and communicates financial and business data
 - d. Regulatory function that prevents the issuance of improper financial information
26. A financial statement audit:
 - a. Confirms that financial statement assertion are accurate.
 - b. Lends credibility to the financial statements.
 - c. Guarantees that financial statements are presented fairly.
 - d. Assures that fraud had been detected.
27. Which of the following best describes the objective of an audit of financial statements?
 - a. To express an opinion whether the financial statements are prepared in accordance with prescribed criteria.
 - b. To express an assurance as to the future viability of the entity whose financial statements are being audited.
 - c. To express an assurance about the management's efficiency or effectiveness in conducting the operations of entity.
 - d. To express an opinion whether the financial statements are prepared, in all material respect, in accordance with an identified financial reporting framework.
28. Because an external auditor is paid a fee by a client company, he or she
 - a. Is absolutely independent and may conduct an audit

- b. May be sufficiently independent to conduct an audit
c. Is never considered to be independent
d. Must receive approval of the Securities and Exchange Commission before conducting an audit
29. Which of the following is responsible for an entity's financial statements?
a. The entity's management
b. The entity's internal auditors
c. The entity's audit committee
d. The entity's board of directors
30. The best statement of the responsibility of the auditor with respect to audited financial statement is:
a. The audit of the financial statements relieves management of its responsibilities
b. The auditor's responsibility is confined to his expression of opinion about the audited financial statements.
c. The responsibility over the financial statements rests with the management and the auditor assumes responsibility with respect to the notes of financial statements.
d. The auditor is responsible only to his unqualified opinion but not for any other type of opinion.
31. Which of the following least likely limits the auditors ability to detect material misstatement?
a. Most audit evidences are conclusive rather than being persuasive.
b. The inherent limitations of any accounting and internal control system.
c. Audit is based on testing
d. Audit procedures that are effective in detecting ordinary misstatements are ineffective in detecting intentional misstatements.
32. Because an examination in accordance with generally accepted auditing standards is influenced by the possibility of material errors, the auditor should conduct the examination with an attitude of
a. Professional responsiveness
b. Conservative advocacy
c. Objective judgment
d. Professional skepticism
33. Which of the following best describes why an independent auditor reports on financial statements?
a. Independent auditors are likely to detect fraud
b. Competing interests may exist between management and the users of the statements
c. Misstated account balances are generally corrected by an independent audit.
d. Ineffective internal controls may exist.
34. An audit can have a significant effect on
a. Information Risk
b. The risk-free interest rate
c. Business Risk
d. All of these
35. The main way(s) to reduce information risk is to have
a. The user verify the information
b. The user share the information risk with management
c. Audited financial statements provided
d. All of the above
36. Which of the following is an appraisal activity established within an entity as a service to the entity?
a. External auditing
b. Internal auditing
c. Financial auditing
d. Compliance auditing
37. The scope and objectives of internal auditing vary widely and depend on the size and structure of the entity and the requirements of its management. Ordinarily, internal auditing activities include one or more of the following:
- | | <u>a</u> | <u>b</u> | <u>c</u> | <u>d</u> |
|---|----------|----------|----------|----------|
| • Review of the accounting and internal control systems | Yes | Yes | Yes | Yes |
| • Examination of financial and operating information | Yes | Yes | Yes | No |
| • Review of the economy, efficiency and effectiveness of operations | Yes | Yes | No | No |
| • Review of compliance with laws, regulations and other external requirements | Yes | No | No | No |

38. To operate effectively, an internal auditor must be independent of
- a. **The line functions of the organizations**
 - b. The entity
 - c. The employer-employee relationship which exists for other employees in the organization
 - d. All of the above
39. Internal auditors cannot be independent
- a. Since they do not possess the CPA license.
 - b. Because they don't audit financial statements.
 - c. Unless their immediate supervisor is a CPA.
 - d. **As long as an employer-employee relationship exists.**
40. To provide for the greatest degree of independence in performing internal auditing functions, an internal auditor most likely should report to
- a. **Board of Directors.**
 - b. Vice-President for Finance.
 - c. Corporate Controller.
 - d. Corporate Stockholders.
41. Which statement is correct regarding the relationship between internal auditing and the external auditor?
- a. Some judgments relating to the audit of the financial statements are those of the internal auditor.
 - b. The external audit function's objectives vary according to management's requirements.
 - c. **Certain aspects of internal auditing may be useful in determining the nature, timing and extent of external audit procedures.**
 - d. The external auditor is responsible for the audit opinion expressed, however that responsibility may be reduced by any use made of internal auditing.
42. Which of the following statements is not a distinction between independent auditing and internal auditing?
- a. Independent auditors represent third party users external to the auditee entity, whereas internal auditors report directly to management.
 - b. **Although independent auditors strive for both validity and relevance of evidence, internal auditors are concerned almost exclusively with validity.**
 - c. Internal auditors are employees of the auditee, whereas independent auditors are independent contractors.
 - d. The internal auditor's span of coverage goes beyond financial auditing to encompass operational and performance auditing.
43. Which of the following is a correct qualification of the Chairman and Two Commissioners of the Commission on Audit?
- a. A citizen of the Philippines.
 - b. At least 40 years of age upon appointment.
 - c. CPA's with no less than 5 years of auditing experience or members of Philippine bar who have been engaged in law practice for at least 5 years.
 - d. **Must not have been candidates for any elective position preceding appointment.**
44. The 1986 Constitution provides that the Chairman and Commissioners of the Commission on Audit shall be
- a. All Certified Public Accountants
 - b. All lawyers
 - c. **One or two lawyers and one or two CPAs for a total of three**
 - d. Two lawyers and one CPA
45. Which of the following is not one of the duties of the Commission on Audit
- a. Define the scope of its audit and examination
 - b. **Assume fiscal responsibility for the government and its instrumentalities**
 - c. Keep the general accounts of the government
 - d. Promulgate accounting rules and regulations
46. A governmental audit may extend beyond an examination leading to the expression of an opinion on the fairness of financial presentation to include
- | | <u>Program results</u> | <u>Compliance</u> | <u>Economy and efficiency</u> |
|----|------------------------|-------------------|-------------------------------|
| a. | Yes | Yes | No |
| b. | Yes | Yes | Yes |
| c. | No | Yes | Yes |
| d. | No | No | Yes |

47. An audit designed to determine the extent to which the desired results of an activity established by the legislative or other authorizing body are being achieved is a (an)
- Economy audit
 - Efficiency audit
 - Program audit**
 - Financial related audit
48. A government auditor evaluates a disbursement to determine if it is necessary, excessive or extravagant in accordance with existing rules and regulations. What kind of audit is he conducting?
- | | <u>Compliance audit</u> | <u>Economy audit</u> |
|----|-------------------------|----------------------|
| a. | Yes | No |
| b. | No | Yes |
| c. | Yes | Yes |
| d. | No | No |

QUIZZERS

- Which of the following is an incorrect phrase?
 - Auditing is a systematic process.
 - Auditing subjectively obtains and evaluates evidence.**
 - Auditing evaluates evidence regarding assertions.
 - Auditing communicates results to interested users.
- Which of the following is a correct statement relating to the theoretical framework of auditing?
 - The financial data to be audited can be verified.**
 - Short-term conflicts do not exist between managers who prepare data and auditors who examine data.
 - Auditors do not necessarily need independence.
 - An audit has a benefit only to the owners.
- The essence of the attest function is to
 - Detect fraud
 - Examine individual transactions so that the auditor can certify as to their validity
 - Determine whether the client's financial statements are fairly stated**
 - Ensure the consistent application of correct accounting procedures
- In "auditing" accounting data, the concern is with
 - Determining whether recorded information properly reflects the economic events that occurred during the accounting period.**
 - Determining if fraud has occurred.
 - Determining if taxable income has been calculated correctly.
 - Analyzing the financial information to be sure that it complies with government requirements.
- Users of financial statements demand independent audit because
 - Users demand assurance that fraud does not exist
 - Management may not be objective in reporting.**
 - Users expect auditors to correct management errors.
 - Management relies on the auditor to improve internal control.
- Which of the following types of audits is performed to determine whether an entity's financial statements are fairly stated in conformity with generally accepted accounting principles?
 - Operational audit
 - Compliance audit
 - Financial statement audit**
 - Performance audit
- Which of the following types of auditing is performed most commonly by CPAs on a contractual basis?
 - Internal auditing
 - BIR auditing
 - Government auditing
 - External auditing**

PSA 100 – Assurance engagements

- Which of the following is incorrect regarding the Philippine Standards on Assurance Engagements (PSAE)?
 - It provides an overall framework for assurance engagements intended to provide either a high or moderate level of assurance.

- b. It provides basic principles and essential procedures for engagements intended to provide a moderate level of assurance.
- c. When a professional accountant is engaged to perform an assurance engagement for which specific standards exist, those standards apply.
- d. If no specific standards exist for an assurance engagement, PSAE apply.
9. An assurance engagement should exhibit the following elements except
- a. A three party relationship
- b. A conclusion
- c. Appropriate professional fee
- d. A subject matter
10. Which of the following is incorrect regarding the “three-party relationship” element of assurance engagements?
- a. Professional accountants as those persons who are members of an IFAC member body, which should be in public practice.
- b. The responsible party and the intended user will often be from separate organizations but need not be.
- c. The responsible party is the person or persons, either as individuals or representatives of an entity, responsible for the subject matter.
- d. The intended user is the person or class of persons for whom the professional accountant prepares the report for a specific use or purpose.
11. The following are assurance engagements except
- a. Financial statements audit
- b. Information system reliability services
- c. Review of financial statements
- d. Tax consulting
12. Engagements frequently performed by professional accountants that are not assurance engagements include the following except
- a. Agreed-upon procedures.
- b. Compliance audit
- c. Compilation
- d. Management consulting.
13. The subject matter of an assurance engagement may take many forms, including
- a. Data
- b. Systems and processes
- c. Behavior
- d. All of these
14. The decision as to whether the criteria are suitable involves considering whether the subject matter is capable of reasonably consistent evaluation against or measurement using such criteria. The characteristics for determining whether criteria are suitable include the following, except
- a. Relevance
- b. Reliability:
- c. Understandability:
- d. Sufficiency
15. When the professional accountant has obtained sufficient appropriate evidence to conclude that the subject matter conforms in all material respects with identified suitable criteria, he or she can provide what level of assurance?
- a. None
- b. High
- c. Moderate
- d. Absolute
16. Absolute assurance is generally not attainable as a result of such factors as:
- | | <u>a</u> | <u>b</u> | <u>c</u> | <u>d</u> |
|--|----------|----------|----------|----------|
| • the use of selective testing, | Yes | Yes | Yes | No |
| • the inherent limitations of control systems | Yes | Yes | Yes | Yes |
| • the fact that much of the evidence available to the professional accountant is persuasive rather than conclusive | Yes | Yes | No | Yes |
| • the use of judgment in gathering evidence and drawing conclusions based on that evidence | Yes | No | No | No |

PSA 120 – Framework of PSA

17. The Framework of PSA applies to
- a. Taxation
- b. Consultancy
- c. Accounting advice
- d. Compilation
18. Agreed-upon procedures provides what level of assurance?
- a. None
- b. High
- c. Moderate
- d. Absolute
19. Which of the following procedures ordinarily performed during an audit are also performed in review?
- a. Assessment of accounting and internal control systems
- b. Test of controls
- c. Tests of records and of responses to inquiries

d. Inquiry and analytical procedures

20. The objective of a review of financial statements
- a. Is to enable the auditor to express an opinion whether the financial statements are prepared, in all material respects, in accordance with an identified financial reporting framework.
 - b. Is to enable an auditor to state whether, on the basis of procedures which do not provide all the evidence that would be required in an audit, anything has come to the auditor's attention that causes the auditor to believe that the financial statements are not prepared, in all material respects, in accordance with an identified financial reporting framework.
 - c. Is to carry out those procedures of an audit nature to which the auditor and the entity and any appropriate third parties have agreed and to report on factual findings.
 - d. Is to use accounting expertise as opposed to auditing expertise to collect, classify and summarize financial information.
21. An auditor is associated with financial information when
- | | <u>a</u> | <u>b</u> | <u>c</u> | <u>d</u> |
|--|----------|----------|----------|----------|
| • the auditor attaches a report to that information | Yes | No | Yes | No |
| • consents to the use of the auditor's name in a professional connection | Yes | Yes | No | No |

PSA 200 – Objective and general principles governing an audit of FS

22. The auditor's opinion
- a. Enhances the credibility of the financial statements.
 - b. Is an assurance as to the future viability of the entity.
 - c. Is an assurance as to the efficiency with which management has conducted the affairs of the entity, but not effectiveness.
 - d. Certifies the correctness of the financial statements.
23. Which of the following is incorrect regarding the general principles of an audit?
- a. The auditor should comply with the "Code of Ethics for Professional Ethics for Certified Public Accountants" promulgated by the Philippine Professional Regulation Commission.
 - b. The auditor should conduct an audit in accordance with PSAs.
 - c. The auditor should plan and perform an audit with an attitude of professional skepticism recognizing that circumstances may exist that cause the financial statements to be materially misstated.
 - d. The auditor would ordinarily expect to find evidence to support management representations and assume they are necessarily correct.
24. It refers to the audit procedures deemed necessary in the circumstances to achieve the objective of the audit.
- | | |
|----------------------|--------------------------|
| a. Scope of an audit | c. Objective of an audit |
| b. Audit program | d. Reasonable assurance |
25. Which of the following are sources of procedures to be considered by the auditor to conduct an audit in accordance with PSAs?
- | | <u>PSA</u> | <u>Legislation</u> | <u>Terms of Audit Engagement</u> | <u>Type of Opinion</u> |
|----|------------|--------------------|----------------------------------|------------------------|
| a. | Yes | No | No | No |
| b. | No | No | Yes | Yes |
| c. | No | Yes | Yes | No |
| d. | Yes | Yes | Yes | No |

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