

# CPA REVIEW SCHOOL OF THE PHILIPPINES

Manila

## AUDITING THEORY

### OTHER PSAs and PAPSSs

*Related PSAs/PAPSSs: PSA 501, 505, 510, 520, 540, 545, 550, 620, 560 and 580  
PAPS 1000, 1005 and 1000Ph*

#### PSA 501 – Audit Evidence – Additional Considerations on Specific Items

1. When inventory is material to the financial statements, the auditor should obtain sufficient appropriate audit evidence regarding its existence and condition by attendance at physical inventory counting unless impracticable. Where attendance is impracticable, due to factors such as the nature and location of the inventory, the auditor should
  - a. Take or observe some physical counts on an alternative date and, when necessary, perform tests of intervening transactions.
  - b. Consider whether alternative procedures provide sufficient appropriate audit evidence of existence and condition to conclude that the auditor need not make reference to a scope limitation.
  - c. Issue qualified or disclaimer of opinion.
  - d. Issue qualified or adverse opinion.
2. When litigation or claims have been identified or when the auditor believes they may exist, the auditor should
  - a. Seek direct communication with the entity's lawyers.
  - b. Disclose the litigation and claims in the auditor's report.
  - c. Issue unqualified opinion with explanatory paragraph.
  - d. Issue qualified or adverse opinion.
3. The auditor should carry out procedures in order to become aware of any litigation and claims involving the entity which may have a material effect on the financial statements. Such procedures least likely include
  - a. Making appropriate inquiries of management including obtaining representations.
  - b. Reviewing board minutes and correspondence with the entity's lawyers.
  - c. Examining interest expense accounts.
  - d. Using any information obtained regarding the entity's business including information obtained from discussions with any in-house legal department.
4. The primary source of information to be reported about litigation, claims, and assessments is the
 

a. Client's lawyer	c. Client's management
b. Court records	d. Independent auditor
5. The primary reason an auditor requests that letters of inquiry be sent to a client's attorneys is to provide the auditor with
  - a. The probable outcome of asserted claims and pending or threatened litigation.
  - b. Corroboration of the information furnished by management about litigation, claims, and assessments.
  - c. The attorneys' opinions of the client's historical experiences in recent similar litigation.
  - d. A description and evaluation of litigation, claims, and assessments that existed at the balance sheet date.
6. Which of the following statements concerning litigation, claims, and assessments, which were extracted from a letter from a client's lawyer, is most likely to cause the auditor to request clarification?
  - a. "I believe that the possible liability to the company is nominal in amount."
  - b. "I believe that the action can be settled for less than the damages claimed."
  - c. "I believe that the plaintiff's case against the company is without merit."
  - d. "I believe that the company will be able to defend this action successfully."
7. The appropriate date for the client to specify as the effective date in the audit inquiry to a lawyer is
  - a. The balance sheet date.
  - b. Seven working days after the request is received by the lawyer.
  - c. The date of the audit inquiry itself.

- d. The expected date of the completion of audit field work.
8. The refusal of a client's lawyer to provide a representation on the legality of a particular act committed by the client is ordinarily
- Sufficient reason to issue a "subject to" opinion.
  - Considered to be a scope limitation.
  - Insufficient reason to modify the auditor's report because of the lawyer's obligation of confidentiality.
  - Proper grounds to withdraw from the management.
9. Which statement is incorrect regarding valuation and disclosure of long-term investments?
- When long-term investments are material to the financial statements, the auditor should obtain sufficient appropriate audit evidence regarding their valuation and disclosure.
  - Audit procedures regarding long-term investments ordinarily include considering evidence as to whether the entity has the ability to continue to hold the investments on a long term basis.
  - If market quotations exceed the carrying amounts, the auditor would consider whether a write-down is required.
  - If there is an uncertainty as to whether the carrying amount will be recovered, the auditor would consider whether appropriate adjustments and/or disclosures have been made.
10. Which statement is incorrect regarding segment information?
- Segment information is information in the financial statements regarding distinguishable components or industry and geographical aspects of an entity.
  - When segment information is material to the financial statements, the auditor should obtain sufficient appropriate audit evidence regarding its disclosure in accordance with generally accepted accounting principles in the Philippines.
  - The auditor considers segment information in relation to the financial statements taken as a whole, and is ordinarily required to apply auditing procedures that would be necessary to express an opinion on the segment information standing alone.
  - Audit procedures regarding segment information ordinarily consist of analytical procedures and other audit tests appropriate in the circumstances.

#### PSA 505 – External Confirmations

11. Which statement is incorrect regarding external confirmation?
- External confirmation is the process of obtaining and evaluating audit evidence through a direct communication from a third party in response to a request for information about a particular item affecting assertions made by management in the financial statements.
  - External confirmation of an account receivable provides strong evidence regarding the valuation of the account as at a certain date.
  - The auditor should tailor external confirmation requests to the specific audit objective.
  - The auditor may use positive or negative external confirmation requests or a combination of both.
12. Negative confirmation requests is unlikely to be used to reduce audit risk to an acceptable level when:
- The assessed level of inherent and control risk is low.
  - A large number of small balances is involved.
  - A substantial number of errors is expected.
  - The auditor has no reason to believe that respondents will disregard these requests.
13. An auditor should perform alternative procedures to substantiate the existence of accounts receivable when
- No reply to a positive confirmation request is received.
  - No reply to a negative confirmation request is received.
  - Collectability of the receivables is in doubt.
  - Pledging of the receivables is probable.

PSA 510 – Initial Engagements – Opening Balances

14. For initial audit engagements, the auditor should obtain sufficient appropriate audit evidence that:
- The opening balances do not contain misstatements that materially affect the current period's financial statements.
  - The prior period's closing balances have been correctly brought forward to the current period or, when appropriate, have been restated.
  - Appropriate accounting policies are consistently applied or changes in accounting policies have been properly accounted for and adequately disclosed.
  - All of the above.**
15. Opening balances means those account balances which exist at the beginning of the period. These are based upon the closing balances of the prior period and reflect the effects of:
- Current transactions (e.g. stock dividends) that will be given retroactive effect recognition.
  - Transactions of prior periods.
  - Accounting policies applied in the prior period.
- All of these
  - I and II only
  - I only
  - II and III only**
16. Which of the following is least considered in determining the sufficiency and appropriateness of the audit evidence that the auditor will obtain regarding opening balances?
- The length of years in operations of the entity.**
  - The materiality of the opening balances relative to the current period's financial statements.
  - The accounting policies adopted by the entity.
  - The risk of misstatements of accounts.
17. Which of the following accounts is more difficult for the auditor to be satisfied as to the balance at the beginning of the period?
- Accounts receivable
  - Accounts payable
  - Inventory**
  - Accrued interest payable
18. If, after performing necessary audit procedures, the auditor is unable to obtain sufficient appropriate audit evidence concerning opening balances, the auditor's report should include:
- A qualified opinion
  - A disclaimer of opinion
  - An opinion which is qualified or disclaimed regarding the results of operations and cash flows and unqualified regarding financial position
- Any of the above**
  - None of the above
  - Either I or II
  - I only
19. If the opening balances contain misstatements which could materially affect the current period's financial statements and the effect of the misstatement is not properly accounted for and adequately disclosed, the auditor should express a
- Unqualified opinion with explanatory paragraph.
  - Qualified or adverse opinion.**
  - Qualified or disclaimer of opinion.
  - Adverse or disclaimer of opinion.
20. If the current period's accounting policies have not been consistently applied in relation to opening balances and if the change has not been properly accounted for and adequately disclosed, the auditor should express a
- Unqualified opinion with explanatory paragraph.
  - Qualified or adverse opinion.**
  - Qualified or disclaimer of opinion.
  - Adverse or disclaimer of opinion.

PSA 520 – Analytical Procedures

21. It means the analysis of significant ratios and trends including the resulting investigation of fluctuations and relationships that are inconsistent with other relevant information or which deviate from predicted amounts.
- Analytical procedures**
  - Substantive procedures
  - Tests of controls
  - Audit sampling
22. Analytical procedures are used for the following purposes, except:
- To assist the auditor in planning the nature, timing and extent of other audit procedures.
  - As a test performed to obtain audit evidence about the suitability of design and effective operation of the accounting and internal control systems.**

- c. As substantive procedures when their use can be more effective or efficient than tests of details in reducing detection risk for specific financial statement assertions.
  - d. As an overall review of the financial statements in the final review stage of the audit.
23. Analytical procedures enable the auditor to predict the balance or quantity of an item under audit. Information to develop this estimate can be obtained from all of the following, except
- a. Comparison of financial data with data for comparable prior periods, anticipated results (e.g., budgets and forecasts), and similar data for the industry in which the entity operates.
  - b. Study of the relationships of elements of financial data that would be expected to conform to a predictable pattern based upon the entity's experience.
  - c. Study of the relationships of financial data with relevant nonfinancial data.
  - d. **Tracing transactions through the system to determine whether procedures are being applied as prescribed.**
24. Analytical procedures used as a substantive procedure focus on
- a. Understanding the business and in identifying areas of potential risk.
  - b. **Detecting material misstatements in the financial statements.**
  - c. Obtaining audit evidence about the suitability of design and effective operation of the accounting and internal control systems
  - d. Whether the financial statements as a whole are consistent with the auditor's knowledge of the business.
25. Which of the following statements concerning analytical procedures is true?
- a. Analytical procedures may be omitted entirely for some financial statement audits.
  - b. Analytical procedures used in planning the audit should not use nonfinancial information.
  - c. Analytical procedures usually are effective and efficient for tests of controls.
  - d. **Analytical procedures alone may provide the appropriate level of assurance for some assertions.**
26. The application of analytical procedures is based on the expectation that relationships among data exist and continue in the absence of known conditions to the contrary. Which of the following items tend to be the most predictable for purposes of analytical procedures applied as substantive tests?
- a. Relationships involving balance sheet accounts.
  - b. Transactions subject to management discretion.
  - c. **Relationships involving income statement accounts.**
  - d. Data subject to audit testing in the prior year.
27. Analytical procedures performed in the overall review stage of an audit suggest that several accounts have unexpected relationships. The results of these procedures most likely indicate that
- a. Irregularities exist among the relevant account balances.
  - b. Internal control activities are not operating effectively.
  - c. **Additional tests of details are required.**
  - d. The communication with the audit committee should be revised.
28. As a result of analytical procedures, the independent auditor determines that the gross profit percentage 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 a misstatement in the financial statements.**
29. An auditor's decision either to apply analytical procedures as substantive tests or to perform tests of transactions and account balances usually is determined by the
- a. Availability of data aggregated at a high level.
  - b. **Relative effectiveness and efficiency of the tests.**
  - c. Timing of tests performed after the balance sheet data.
  - d. Auditor's familiarity with industry trends.

30. An auditor's preliminary analysis of accounts receivable turnover revealed the following rates;

2005	2004	2003
4.3	6.2	7.3

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

- a. Increase in the cash discount offered
  - b. **Liberalization of credit policy**
  - c. Shortening of due date terms
  - d. Increased cash sales
31. Auditors sometimes use comparison of ratios as audit evidence. For example, an unexplained decrease in the ratio of gross profit to sales suggests which of the following possibilities?
- a. Unrecorded purchases
  - b. **Unrecorded sales**
  - c. Merchandise purchases being charged to selling and general expense
  - d. Fictitious sales
32. Analytical procedures used in the overall review stage of an audit generally include
- a. **Considering unusual or unexpected account balances that were not previously identified.**
  - b. Performing tests of transactions to corroborate management's financial statement assertions.
  - c. Gathering evidence concerning account balances that have not changed from the prior year.
  - d. Retesting controls that appeared to be ineffective during the assessment of control risk.
33. The investigation of unusual fluctuations and relationships ordinarily begins with
- a. Identification significant fluctuations or relationships that are inconsistent with other relevant information or that deviate from predicted amounts.
  - b. **Inquiries of management.**
  - c. Comparing management's responses with the auditor's knowledge of the business and other evidence obtained during the course of the audit.
  - d. Consideration of the need to apply other audit procedures.

#### PSA 540 – Audit of Accounting Estimates

34. It means an approximation of the amount of an item in the absence of a precise means of measurement
- a. **Accounting estimate**
  - b. Accounting policy
  - c. Accounting error
  - d. Accounting change
35. The auditor should adopt one or a combination of the following approaches in the audit of an accounting estimate:
- I. Review and test the process used by management to develop the estimate.
  - II. Use an independent estimate for comparison with that prepared by management.
  - III. Review subsequent events which confirm the estimate made.
- a. **Any of the above**
  - b. None of the above
  - c. Either I or II
  - d. I only
36. In evaluating the assumptions on which the estimate is based, the auditor would need to pay particular attention to assumptions which are
- a. Reasonable in light of actual results in prior periods.
  - b. Consistent with those used for other accounting estimates.
  - c. Consistent with management's plans which appear appropriate.
  - d. **Subjective or susceptible to material misstatement.**

#### PSA 545 – Auditing Fair Value Measurements and Disclosures

37. Which statement is incorrect regarding auditing fair value measurements and disclosures?
- a. The auditor should obtain sufficient appropriate audit evidence that fair value measurements and disclosures are in accordance with GAAP in the Philippines.
  - b. Many measurements based on estimates, including fair value measurements, are inherently imprecise.
  - c. The auditor's consideration of such assumptions is based on information available to the auditor at the time of the audit.
  - d. **The auditor is responsible for predicting future conditions, transactions or events which, had they been known at the time of the audit, may have had a significant effect on management's actions or management's assumptions underlying the fair value measurements and disclosures.**



38. Which statement is incorrect regarding fair value measurements?
- Underlying the concept of fair value measurements is a presumption that the entity is a going concern.
  - Fair value is normally the amount that an entity would receive or pay in a forced transaction, involuntary liquidation, or distress sale.**
  - The measurement of fair value may be relatively simple for assets that are bought and sold in active and open markets.
  - The estimation of fair value may be achieved through the use of a valuation model or through the assistance of an expert, such as an independent appraiser.
39. The degree to which a fair value measurement is susceptible to misstatement is a(an)
- Audit risk
  - Inherent risk**
  - Control risk
  - Detection risk
40. Regarding fair value measurements and disclosures, the auditor is not required to
- Obtain evidence about management's intent to carry out specific courses of action, and consider its ability to do so, where relevant to the fair value measurements and disclosures under GAAP in the Philippines.
  - Evaluate whether the entity's method for its fair value measurements is applied consistently.
  - Use the work of an expert.**
  - Test the entity's fair value measurements and disclosures.
41. Which of the following is ordinarily the best evidence of fair value?
- Published price quotations in an active market.**
  - Discounted cash flow analysis.
  - Comparative transaction model.
  - None of the above.
42. When testing the entity's fair value measurements and disclosures, the auditor evaluates whether:
- The assumptions used by management are reasonable.
  - The fair value measurement was determined using an appropriate model, if applicable.
  - Management used relevant information that was reasonably available at the time.
  - All of the above.**

#### PSA 550 – Related Parties

43. Which statement is incorrect regarding the auditor's responsibilities and audit procedures regarding related parties and transactions with such parties?
- The auditor should perform audit procedures designed to obtain sufficient appropriate audit evidence regarding the identification and disclosure by management of related parties and the effect of related party transactions that are material to the financial statements.
  - An audit cannot be expected to detect all related party transactions.
  - The auditor is responsible for the identification and disclosure of related parties and transactions with such parties.**
  - The auditor needs to have a level of knowledge of the entity's business and industry that will enable identification of the events, transactions and practices that may have a material effect on the financial statements.
44. When auditing related-party transactions, an auditor places primary emphasis on
- Confirming the existence of the related parties.
  - Verifying the valuation of the related-party transactions.
  - Evaluating the disclosure of the related-party transactions.**
  - Ascertaining the rights and obligations of the related parties.
45. After determining that a related-party transaction has, in fact, occurred, and auditor should
- Add a separate paragraph to the auditor's standard report to explain the transaction.
  - Perform analytical procedures to verify whether similar transactions occurred, but were not recorded.
  - Obtain an understanding of the business purpose of the transaction.**
  - Substantiate that the transaction was consummated on terms equivalent to an arm's-length transaction.

46. Which of the following least likely indicates the existence of previously unidentified related parties?
- a. Transactions which have abnormal terms of trade., such as unusual prices, interest rates, guarantees, and repayment terms.
  - b. Transactions which lack an apparent logical business reason for their occurrence.
  - c. Transactions in which substance does not differ from form.
  - d. Unrecorded transactions such as the receipt or provision of management services at no charge.

PSA 620 – Using the Work of an Expert

47. Which statement is incorrect regarding the auditor's use of the work of an expert?
- a. When using the work performed by an expert, the auditor should obtain sufficient appropriate audit evidence that such work is adequate for the purposes of the audit.
  - b. "Expert" means a person or firm possessing special skill, knowledge and experience in a particular field other than accounting and auditing.
  - c. The auditor's education and experience enable the auditor to be knowledgeable about business matters in general, but the auditor is not expected to have the expertise of a person trained for or qualified to engage in the practice of another profession or occupation.
  - d. When the auditor uses the work of an expert employed by the auditor, that work is used in the employee's capacity as an assistant on the audit.

48. An expert may be:

	<u>A</u>	<u>B</u>	<u>C</u>	<u>D</u>
Engaged by the entity	Yes	No	Yes	Yes
Engaged by the auditor	No	Yes	Yes	Yes
Employed by the entity	Yes	No	No	Yes
Employed by the auditor	No	Yes	No	Yes

49. Which of the following least likely requires the services of an expert?
- a. Valuations of certain types of assets like land and buildings.
  - b. Legal opinions concerning interpretations of engagements, statutes and regulations.
  - c. Determination of amounts using specialized techniques.
  - d. Application of accounting methods in computing inventory balances.
50. When the auditor has to determine the need to use the work of an expert, he would least likely consider:
- a. The cost of using the services of an expert.
  - b. The quantity and quality of other audit evidence available.
  - c. The materiality of the financial statement item being considered.
  - d. The risk of misstatement based on the nature and complexity of the matter being considered.
51. Which of the following statements concerning the auditor's use of the work of a specialist is true?
- a. If the auditor believes that the determinations made by the specialist are unreasonable, only a qualified opinion may be expressed.
  - b. If the specialist is related to the client, the auditor is still permitted to use the specialist's findings as corroborative evidence.
  - c. The specialist may not be related to the client.
  - d. The specialist is identified in the auditor's report when the auditor expresses an unqualified opinion.
52. In using the work of a specialist, an auditor referred to the specialist's findings in the auditor's report. This is an appropriate reporting practice if the
- a. Auditor is not familiar with the professional certification, personal reputation, or particular competence of the specialist.
  - b. Auditor, as a result of the specialist's findings, adds an explanatory paragraph emphasizing a matter regarding the financial statements.
  - c. Specialist is aware that his/her work will be used to evaluate the assertions in the financial statements.
  - d. Auditor, as a result of the specialist's findings, decides to indicate a division of responsibility with the specialist.

PSA 560 – Subsequent Events

53. Which of the following statements best expresses the auditor's responsibility with respect to events occurring in the subsequent events period?
- The auditor has no responsibility for events occurring in the subsequent period unless these events affect transactions recorded on or before the balance sheet date.
  - The auditor's responsibility is to determine that transactions recorded on or before the balance sheet date actually occurred.
  - The auditor is fully responsible for events occurring in the subsequent period and should extend all detailed procedures through the last day of field work.
  - The auditor is responsible for determining that a proper cutoff has been made and for performing a general review of events occurring in the subsequent period.**
54. Which of the following procedures should an auditor ordinarily perform regarding subsequent events?
- Compare the latest available interim financial statements with the financial statements being audited.**
  - Send second requests to the client's customer who failed to respond to initial accounts receivable confirmation requests.
  - Communicate material weaknesses in the internal control to the client's audit committee.
  - Review the cutoff bank statements for several months after the year-end.
55. Which of the following is least likely a procedure that would be performed by the auditor near the auditor's report date?
- Reading the minutes of the meetings of shareholders, the board of directors and audit executive committees held throughout the audit year.**
  - Reading the entity's latest available interim financial statements.
  - Inquiring of the client's legal counsel concerning litigations and claims.
  - Reviewing the procedures that management has established to ensure that subsequent events are identified.
56. After issuing a report, an auditor has no obligation to make continuing inquiries or perform other procedures concerning audited financial statements, unless
- Information, which existed at the report date and may affect the report, comes to the auditor's attention.**
  - The control environment changes after issuance of the report.
  - Information about an event that occurred after the end of field work comes to the auditor's attention.
  - Final determinations or resolutions are made of contingencies that had been disclosed in the financial statements.

PSA 580 – Management Representations

57. The auditor should obtain evidence that management acknowledges its responsibility for the fair presentation of the financial statements in accordance with GAAP in the Philippines, and has approved the financial statements. The auditor can obtain evidence of management's acknowledgment of such responsibility and approval
- From relevant minutes of meetings of the board of directors or similar body.
  - By obtaining a written representation from management.
  - By obtaining a signed copy of the financial statements.
- a. **Any of the above**      b. Either I or II      c. I only      d. None of the above
58. A purpose of a management representation letter is to reduce
- Audit risk to an aggregate level of misstatement that could be considered material.
  - An auditor's responsibility to detect material misstatements only to the extent that the letter is relied on.
  - The possibility of a misunderstanding concerning management's responsibility for the financial statements.**
  - The scope of an auditor's procedures concerning related party transactions and subsequent events.
59. When an audit is made in accordance with Philippine Standards on Auditing, the auditor should always



- a. Document the understanding of the client's internal control and the basis for all conclusions about the assessed level of control risk for financial statement assertions.
  - b. Employ analytical procedures as substantive tests to obtain evidence about specific assertions related to account balances.
  - c. Obtain appropriate representations from management.
  - d. Observe the taking of physical inventory on the balance sheet date.
60. For which of the following matters should an auditor obtain written management representations?
- a. Management's cost-benefit justifications for not correcting internal control weaknesses.
  - b. Management's knowledge of future plans that may affect the price of the entity's stock.
  - c. Management's compliance with contractual agreements that may affect the financial statements.
  - d. Management's acknowledgment of its responsibility for employee's violations of laws.
61. When considering the use of management's written representations as audit evidence about the completeness assertion, an auditor should understand that such representations
- a. Complement, but do not replace, substantive tests designed to support the assertion.
  - b. Constitute sufficient evidence to support the assertion when considered in combination with a sufficiently low assessed level of control risk.
  - c. Are not part of the evidence considered to support the assertion.
  - d. Replace a low assessed level of control risk as evidence to support the assertion.
62. A written representation from a client's management that, among other matters, acknowledges responsibility for the fair presentation of financial statements, should normally be signed by the
- a. Chief executive officer and the chief financial officer.
  - b. Chief financial officer and the chair of the board of directors.
  - c. Chair of the audit committee of the board of directors.
  - d. Chief executive officer, the chair of the board of directors, and the client's lawyer.
63. If management refuses to furnish certain written representations that the auditor believes are essential, which of the following is appropriate?
- a. The auditor can rely on oral evidence relating to the matter as a basis for an unqualified opinion.
  - b. The client's refusal does not constitute a scope limitation that may lead to a modification of the opinion.
  - c. The client's refusal may have an effect on the auditor's ability to rely on other representations of management.
  - d. The auditor should express an adverse opinion because of management's refusal.
64. A management representation letter would ordinarily be dated as of the
- a. Date the report is delivered to the entity audited.
  - b. Date the financial statements were approved by the client management.
  - c. Balance sheet date of the latest period reported on.
  - d. Date a letter of audit inquiry is received from the entity's attorney of record.

#### PAPS 1000 – Inter-Bank Confirmation Procedures

65. The purpose of this Statement is to provide assistance on inter-bank confirmation procedures to the external independent auditor, to bank management, such as internal auditors, and to BSP examiners.
- a. PAPS 1000
  - b. PAPS 1004
  - c. PAPS 1005
  - d. PAPS 1006
66. Which statement is incorrect regarding inter-bank confirmations?
- a. The requirement for bank confirmation arises from the need of the bank's management and its auditors to confirm the financial and business relationships.
  - b. While inter-bank relationships are similar in nature to those between the bank and a non-bank customer, there may be special significance in some inter-bank relationships.
  - c. The auditor should decide from which bank or banks to request confirmation, have regard to such matters as size of balances, volume of activity, degree of reliance on internal controls, and materiality within the context of the financial statements.
  - d. It is usual practice to request a response only if the information submitted is incorrect or incomplete.

67. Encumbrance is

- a. A security given by a borrower to a lender as a pledge for repayment of a loan, rarely given in the case of inter-bank business.
- b. A potential liability, which only crystallize upon the fulfillment of or the failure to fulfill certain conditions.
- c. A claim or lien, such as a mortgage upon real property, which diminishes the owner's equity in the property.
- d. The right of a bank, normally evidenced in writing, to take possession of any account balances that a guarantor or debtor may have with it to cover the obligations to the bank of the guarantor, debtor or third party.

#### PAPS 1005 – The Special Consideration In An Audit of Small Entities

68. A small entity is any entity in which the following can be found, except

- a. There is concentration of ownership and management in a small number of individuals (often a single individual).
- b. Numerous sources of income.
- c. Unsophisticated record-keeping.
- d. Limited internal controls together with the potential for management override of controls.

69. Which of the following factors are considered in determining the applicability of PSAs in an audit of financial statements?

	<u>a</u>	<u>b</u>	<u>c</u>	<u>d</u>
• Size of the entity	Yes	Yes	Yes	No
• Legal form of the entity	Yes	No	Yes	No
• Ownership or management structure of the entity	Yes	Yes	No	No
• Nature of the entity's activities	Yes	Yes	No	No

70. Which statement is incorrect regarding small entities?

- a. Small business entities ordinarily have few owners; often there is a single proprietor.
- b. Record keeping may be unsophisticated or poor, which results in a greater risk that the financial statements may be inaccurate or incomplete.
- c. Size and economic considerations in small entities mean that internal controls are often neither necessary nor desirable.
- d. In many small entities, accounting populations are often small and easily analyzed.

71. Which of the following quality control policies and procedures may not be relevant sole practitioners with no assistants auditing small entities?

- a. Consultation
- b. Monitoring
- c. Assignment
- d. Professional requirements

72. Which statement is correct regarding the application of PSAs to audit of small entities?

- a. The auditor's in-depth understanding of the entity and its business may eliminate the need for the auditor to maintain adequate working papers.
- b. The auditor would not ordinarily accept an audit engagement in which the terms of the engagement are such that the auditor believes that the need to express a disclaimer of opinion exists.
- c. The requirements of PSA 220 relating to quality control on individual audits are not relevant to audit of small entities.
- d. All small entities are to be regarded by the auditor as necessarily involving a higher risk of fraud or error than larger entities.

73. In the audit of small entities, there are particular problems in obtaining audit evidence to support what assertion?

- a. Existence
- b. Completeness
- c. Valuation
- d. Rights

74. Which of the following services is prohibited to be rendered to an audit client?

- a. Bookkeeping services.
- b. Advising on the selection and application of accounting policies.
- c. Assisting with the preparation of financial statements.
- d. All of the above.

PAPS 1000ph – Audit Evidence-Practical Problems in Audit of Financial Statements

75. PAPS 1000ph focuses on

- a. The scope limitations due to the inability of the client to prepare schedules, reports or computations or the failure to reconcile differences in audit due to the poor condition of the accounting records.
- b. Instances when the documents or information exist but are not made available to the auditor.
- c. Instances when the scope limitation is imposed by the client or by circumstances.
- d. Instances when a particular audit procedure is beyond the area of expertise of the auditor.

76. The additional audit procedures to be performed by the auditor when the client fails to prepare certain audit requirements may be determined based on the:

- I. Materiality and the importance of the account(s) affected.
- II. Quality of the audit evidence obtained thus far, whether it is an initial audit or a recurring audit.
- III. Feasibility and timeliness of coming up with a solution for the problem.
- IV. Agreed-upon reporting requirements.

- a. I, II, III and IV
- b. I, II and III
- c. I and II
- d. I and IV

77. When management fails to prepare schedules or reports for an item that is material to the financial statements needed by the auditor in his audit despite an earlier agreed-upon timetable, the auditor should not:

- a. Evaluate the reasons why management is unable to prepare his audit requirements.
- b. Discuss with management his position concerning the preparation of the audit requirements as early as the planning stage and not when the audit is almost completed.
- c. Agree on a revised timetable within which the requirements are to be prepared by the management and, where management is still unable to prepare the schedules/reports, decide on the most appropriate course of action under the circumstances.
- d. Prepare his own audit requirements if doing so would compromise his independence since he might end up auditing his own work.

78. Which of the following is incorrect regarding audit procedures to be performed by the auditor when the client fails to prepare certain audit requirements?

- a. The auditor has the responsibility to ensure that management addresses the reasons that prevent management from preparing the auditor's requirements.
- b. When the inadequacy in recordkeeping or accounting records of the client that gives rise to its inability to provide the information being required by the auditor is not corrected or addressed within a reasonable period of time of, say, one year, this could indicate the existence of situations or weaknesses in the system that require the auditor to exercise professional skepticism.
- c. It is sufficient for client to merely prepare a schedule or analysis required by the auditor.
- d. Limiting the discussion of problems or issues encountered during the audit to middle management without involving the people who make decisions is self-defeating and not advisable, regardless of circumstances.

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