

Course No: ACNE 4321  
Course Title: Auditing (I)  
Date: 18 April 2017  
No. of Questions: (5)  
Time: 1 hour  
Using Calculator (NA)

University of Palestine



Second Mid-term Exam  
2<sup>nd</sup> Semester  
2016/2017  
Total Grade: 15

Instructor Name: Mr. Adnan Awad

Student No.: \_\_\_\_\_

Student Name: \_\_\_\_\_

College Name: Business Administration  
Dep. / Specialist: Accounting  
Using Dictionary (No)

**Question # 1** (3 marks ½ mark each)

- 1) The scope paragraph of the standard unqualified audit report states that the audit is designed to:
  - A) Discover all errors and/or irregularities.
  - B) Discover material errors and/or irregularities.
  - C) Conform to generally accepted accounting principles.
  - D) Obtain reasonable assurance whether the statements are free of material misstatement.
  
- 2) The audit report date on a standard unqualified report indicates:
  - A) The last day of the fiscal period.
  - B) The date on which the financial statements were filed with the Securities and Exchange Commission.
  - C) The last date on which users may institute a lawsuit against either client or auditor.
  - D) The last day of the auditor's responsibility for the review of significant events that occurred subsequent to the date of the financial statements.
  
- 3) The introductory paragraph of the standard audit report states that the financial statements are:
  - A) The responsibility of the auditor.
  - B) The responsibility of management.
  - C) The joint responsibility of management and the auditor.
  - D) None of the above.
  
- 4) The introductory paragraph of the standard audit report states that the auditor is:
  - A) Responsible for the financial statements and the opinion on them.
  - B) Responsible for the financial statements.
  - C) Responsible for the opinion on the financial statements.
  - D) Jointly responsible for the financial statements with management.
  
- 5) If the balance sheet of a company is dated December 31, 2011, the audit report is dated February 8, 2012, and both are released on February 15, 2012, this indicates that the auditor has searched for subsequent events that occurred up to:
  - A) December 31, 2011.
  - B) January 1, 2012.
  - C) February 8, 2012.
  - D) February 15, 2012.
  
- 6) In which of the following situations would the auditor most likely issue an unqualified report?
  - A) The client valued ending inventory by using the replacement cost method.
  - B) The client valued ending inventory by using the Next-In-First-Out (NIFO) method.
  - C) The client valued ending inventory at selling price rather than historical cost.
  - D) The client valued ending inventory by using the First-In-First-Out (FIFO) method, but showed the replacement cost of inventory in the Notes to the Financial Statements.

**Question # 2** (2 marks 1 mark each)

Describe the standard unqualified report to be issued for an audit of a private company.

- a) Begin by specifying the seven parts of the report, and then
- b) Discuss the contents of each part.

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**Question # 3** (5 marks ½ mark each)

- 1) The AICPA's Code of Professional Conduct requires independence for all:  
A) Attestation engagements.  
B) Services performed by accountants in public practice.  
C) Accounting and auditing services performed.  
D) Professional work performed by CPAs.
  
- 2) For which of the following professional services must CPAs be independent?  
A) Management advisory services.      B) Audits of financial statements.  
C) Preparation of tax returns.      D) All three of the above.
  
- 3) "Independence" in auditing means:  
A) Maintaining an indirect financial interest.      B) Not being financially dependent on a client.  
C) Taking an unbiased and objective viewpoint.      D) Being an advocate for a client.
  
- 4) A direct financial interest violates independence in which of the following circumstances?  
A) When close relatives such as nondependent children, brothers, and sisters have a significant financial interest in the client.  
B) When close relatives such as nondependent children, brothers, and sisters have any financial interest in the client.  
C) When the CPA owns shares in a mutual fund that has an ownership interest in the client.  
D) When close relatives such as brother, sister, or in-laws are employed by the client
  
- 5) Which of the following statements is true? The CPA firm will lose its independence if:  
A) A staff auditor providing audit services to the client acquires stock in that client.  
B) A staff tax preparer who provides 15 hours of non-audit services to the client acquires stock in that client.  
C) An audit manager in an office different than the office providing audit services has a direct, immaterial financial interest in the audit client.  
D) A covered member has an indirect, immaterial financial interest in an audit client.
  
- 6) The members of a client's "audit committee" should be:  
A) Members of management.      B) Directors who are not a part of company management.  
C) Non-directors and non-managers.      D) Directors and managers.
  
- 7) Auditors are allowed to have an indirect financial interest in an audit client, such as ownership of stock in a client's company by the auditor's brother, as long as the amount of the financial interest is immaterial to the brother.  
  
A) True    B) False

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- 8) Several months after an unqualified audit report was issued, the auditor discovers the financial statements were materially misstated. The client agrees that there are misstatements, but refuses to correct them. He claims that "confidentiality" prevents the CPA from informing anyone.
- A) The Client is correct and the auditor must maintain confidentiality.  
B) The Client is incorrect, but because the audit report has been issued it is too late.  
C) The Client is correct, but to be ethically correct the auditor should violate the confidentiality rule and disclose the error.  
D) The Client is incorrect, and the auditor has an obligation to issue a revised audit report, even if the client will not correct the financial statements.
- 9) In Palestine all owners of a CPA firm must be CPAs who are qualified to practice.
- A) True B) False
- 10) Hamilton Appliance has not paid Katreen Linwood, CPA, her audit fee for the past two years. Katreen is starting work on the current year's audit of Hamilton.

For this situation, (1) decide whether the Code of Professional Conduct has been violated, and (2) briefly explain how the situation violates (or does not violate) the Code of Professional Conduct.

Violation?      Yes      No

Explanation:

**Question # 4** (3 marks ½ mark each)

- 1) Recklessness in the case of an audit is present if the auditor knew an adequate audit was not done but still issued an opinion, even though there was no intent to deceive financial statement users. This description is the legal term for:
- A) Ordinary negligence.                      B) Gross negligence.  
C) Constructive fraud.                        D) Fraud.
- 2) An example of a breach of contract would likely include:
- A) An auditor's refusal to return the client's general ledger book until the client paid last year's audit fees.  
B) A bank's claim that an auditor had a duty to uncover material errors in financial statements that had been relied on in making a loan.  
C) A CPA firm's failure to complete an audit on the agreed-upon date because the firm had a backlog of other work which was more lucrative.  
D) An auditor's claim that the client staff is unqualified.

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- 3) Privity of contract exists between:  
A) auditor and the federal government.                      B) Auditor and third parties.  
C) Auditor and client.    D) Auditor and client attorney.
  
- 4) A CPA firm normally uses one or a combination of four defenses when there are legal claims by clients. Which one of the following is generally not a defense?  
A) Lack of duty    B) Non-negligent performance  
C) Contributory negligence                      D) Foreseeable users
  
- 5) Which of the following is not likely a factor in the increase in the number of lawsuits and sizes of awards to plaintiffs related to auditor behavior in USA?  
A) Increased awareness of auditor responsibilities by users of financial statements.  
B) CPA firms are more willing to settle lawsuits.  
C) Difficulty judges and jurors have in understanding legal matters.  
D) Increased consciousness on the part of the SEC for its responsibility to protect investors.
  
- 6) Which of the auditor's defenses is ordinarily not available when lawsuits are filed by a third party?  
A) Absence of causal connections                      B) Contributory negligence  
C) Non-negligent performance                      D) Lack of duty

**Question # 5 (2 marks 1 mark each)**

- a) Distinguish between what is meant by business failure and audit failure.
  
- b) Discuss at least 3 steps the AICPA and the accounting profession as a whole can and are taking to reduce the practitioner's exposure to lawsuits.

***"Good Luck"***