Chapter 2: Corporate governance and audits

TRUE/FALSE

1. Owners want assurances that the representations made by management and the board are accurate and objectively verifiable.
   ANS: T PTS: 1 DIF: Easy TOP: Corporate governance and auditing

2. Financial transparency relates to how well resources are protected and managed by the company and its management.
   ANS: F PTS: 1 DIF: Easy TOP: Corporate governance and auditing

3. Corporate governance is a process by which the owners, but not the creditors, exert control over the resources of the enterprise.

   ANS: F PTS: 1 DIF: Easy TOP: Corporate governance and auditing

4. Management can influence who sits on the board and the audit committee as well as other governance controls that might be put into place.
   ANS: T PTS: 1 DIF: Easy TOP: Corporate governance and auditing

5. The CLERP 9 Act was enacted, in part, to address fundamental problems in corporate governance.
   ANS: T PTS: 1 DIF: Moderate TOP: Corporate governance responsibilities and failures

6. The board's fundamental objective should be to build a system of internal controls that will ensure the financial statements are free from all error.
   ANS: F PTS: 1 DIF: Moderate TOP: Corporate governance responsibilities and failures

7. Shareholders require accountability as to how the resources that have been entrusted to management and the board have been used.
   ANS: T PTS: 1 DIF: Moderate TOP: Corporate governance and auditing

8. The external auditor has the primary responsibility for creating a culture of performance with integrity and ethical behavior within the client's organisation.
   ANS: F PTS: 1 DIF: Easy TOP: Corporate governance responsibilities and failures

9. Since the board is responsible to protect the interest of the shareholders, independence is not a necessary attribute for board members.
ANS: F PTS: 1 DIF: Moderate TOP: Corporate governance responsibilities and failures

10. Companies must strike the right balance in the appointment of independent and non-independent directors to ensure an appropriate range and mix of expertise, diversity and knowledge on the board.
ANS: T PTS: 1 DIF: Easy TOP: Corporate governance responsibilities and failures

11. It is effective for a board to take a 'check the box' mentality when implementing and complying with governance mandates and best practices.
ANS: F PTS: 1 DIF: Easy TOP: Corporate governance responsibilities and failures

12. The first decade of the twenty-first century has seen more changes in corporate governance than at any time since the Great Depression.
ANS: T PTS: 1 DIF: Easy TOP: Corporate governance responsibilities and failures

13. Governance failures over the past decade were primarily limited to the United States.

ANS: F PTS: 1 DIF: Moderate TOP: Corporate governance responsibilities and failures

14. Board of directors that did not spend sufficient time or have sufficient expertise to perform duties led to corporate governance failures.
ANS: T PTS: 1 DIF: Easy TOP: Corporate governance responsibilities and failures

15. The CLERP 9 Act requires management (both the CEO and CFO) to certify the accuracy of the financial report and provides criminal penalties for materially misstated financial reports.

ANS: T PTS: 1 DIF: Moderate TOP: The CLERP 9 Act 2004 and the ASX Corporate Governance Guidelines (2003) (Since revised)

16. The auditor must not communicate significant audit adjustments to the audit committee.
ANS: F PTS: 1 DIF: Easy TOP: Required audit firm

communication to the audit committee

17. Any major disagreement the auditor has with management should be discussed with the audit committee.
ANS: T PTS: 1 DIF: Moderate TOP: Required audit firm communication to the audit committee

18. The auditor must communicate whether major issues were discussed with management before the auditor was engaged or whether management has consulted with other audit firms on accounting issues.
ANS: T PTS: 1 DIF: Difficult TOP: Required audit firm communication to the audit committee

19. A company with good governance will have an independent board and audit committee members who take their roles seriously and have sufficient time and resources to perform their work.
ANS: T PTS: 1 DIF: Moderate TOP: Importance of good governance to the audit

20. The recent empirical studies have shown that companies with weaker corporate governance have lower costs of capital superior share price returns compared to companies with good corporate governance.
ANS: F PTS: 1 DIF: Moderate TOP: Importance of good governance to the audit

21. An auditor is required to communicate new accounting principles adopted by the organisation to the audit committee.
ANS: T PTS: 1 DIF: Moderate TOP: Required audit firm communication to the audit committee

22. Audit committees are motivated to make sure the auditors do their job, because poor performance on the part of the auditors will directly reflect on the performance of the audit committee members.
ANS: T PTS: 1 DIF: Moderate TOP: Required audit firm communication to the audit committee

23. Standards on Review Engagements (ASREs) apply when an auditor is developing and communicating an opinion on interim financial information.
ANS: T PTS: 1 DIF: Difficult TOP: Framework pronouncements

24. The Standards on Assurance Engagements (ASAEs) only apply to audits or reviews of historical financial information.
ANS: F PTS: 1 DIF: Moderate TOP: Framework pronouncements

25. Understanding the US situation is important as all companies incorporated or listed outside of the US need to comply with the requirements of the *Sarbanes-Oxley Act 2002*.
ANS: F PTS: 1 DIF: Moderate TOP: Framework pronouncements

26. All of the standards start from fundamental principles on how an audit engagement should be planned and conducted and then how the results should be communicated.
ANS: T PTS: 1 DIF: Easy TOP: Framework pronouncements

27. In order to safeguard the auditor's independence, the CPAA and ICCA issued a revised code of conduct in relation to independence and established an independent body to issue such pronouncements, APESB.
ANS: T PTS: 1 DIF: Easy TOP: The CLERP 9 Act 2004 and the ASX Corporate Governance Guidelines (2003) (Since revised)

28. An outcome of the Ramsay Report (2002) was the taking up of a recommendation for the Australian Stock Exchange (now ASX) to take responsibility for corporate governance recommendations.

ANS: T PTS: 1 DIF: Difficult TOP: The CLERP 9 Act 2004 and the ASX Corporate Governance Guidelines (2003) (Since revised)

29. The CLERP 9 Act requires the auditor to make an annual declaration, addressed to the board of directors, that the auditor has maintained independence in accordance with the Act and the rules of the professional accounting bodies.
ANS: T PTS: 1 DIF: Moderate TOP: The CLERP 9 Act 2004 and the ASX Corporate Governance Guidelines (2003) (Since revised)

30. The CLERP 9 Act requires the lead engagement or review audit partners participating in audits to rotate off the engagement every five years.
ANS: T PTS: 1 DIF: Easy TOP: The CLERP 9 Act 2004 and the ASX Corporate Governance Guidelines (2003) (Since revised)

31. The audit committee must be composed of outsiders such as the organisation's lawyer and audit partner.
ANS: F PTS: 1 DIF: Moderate TOP: The CLERP 9 Act 2004 and the ASX Corporate Governance Guidelines (2003) (Since revised)

32. The nominating committee is a standing committee of the board of directors whose purpose is to oversee the accounting and financial reporting processes of the company and the financial statement audits.
ANS: F PTS: 1 DIF: Moderate TOP: Corporate governance responsibilities and failures

33. When operating effectively the audit committee may replace the processes performed by the external auditors.
ANS: F PTS: 1 DIF: Moderate TOP: Corporate governance responsibilities and failures

34. The audit committee will receive feedback from both the internal and external auditors on a number of issues, including the quality of internal controls over financial reporting.
ANS: T PTS: 1 DIF: Easy TOP: The CLERP 9 Act 2004 and the ASX Corporate Governance Guidelines (2003) (Since revised)

35. For public companies, the audit committee must be composed of outside directors who are also all financial experts.
ANS: F PTS: 1 DIF: Moderate TOP: The CLERP 9 Act 2004 and the ASX Corporate Governance Guidelines (2003) (Since revised)

36. The audit committee relies on the internal and external auditors to develop and communicate objective information needed by the audit committee to effectively perform its oversight functions.
ANS: T PTS: 1 DIF: Moderate TOP: The CLERP 9 Act 2004 and the ASX Corporate Governance Guidelines (2003) (Since revised)

37. The audit committee typically would not review the analysis of the Directors' Report section of the annual report filed with ASIC to determine that discussion therein is consistent with the committee's understanding of operational performance.
ANS: F PTS: 1 DIF: Difficult TOP: The CLERP 9 Act 2004 and the ASX Corporate Governance Guidelines (2003) (Since revised)

38. The audit committee has specific oversight responsibilities over the internal audit and financial reporting processes.

ANS: F PTS: 1 DIF: Moderate TOP: The CLERP 9 Act 2004 and the ASX Corporate Governance Guidelines (2003) (Since revised)

39. Management of companies should have the ability to hire and fire the external auditor.
ANS: F PTS: 1 DIF: Moderate TOP: The CLERP 9 Act 2004 and the ASX Corporate Governance Guidelines (2003) (Since revised)

40. The audit committee should have the authority to hire and fire the internal auditors.
ANS: T PTS: 1 DIF: Easy TOP: The CLERP 9 Act 2004 and the ASX Corporate Governance Guidelines (2003) (Since revised)

41. The purpose of the audit committee is to oversee all aspects of the financial reporting process, including preparation and filing of financial statements, internal control over financial reporting and related risks.
ANS: T PTS: 1 DIF: Easy TOP: The CLERP 9 Act 2004 and the ASX Corporate Governance Guidelines (2003) (Since revised)

42. At least half of the members of an audit committee should be composed of independent directors.
ANS: F PTS: 1 DIF: Easy TOP: The CLERP 9 Act 2004 and the ASX Corporate Governance Guidelines (2003) (Since revised)

43. The audit committee is responsible for ensuring that management designs and implements sound internal control, which is essential for reliable financial reporting for any organisation.
ANS: T PTS: 1 DIF: Easy TOP: The CLERP 9 Act 2004 and the ASX Corporate Governance Guidelines (2003) (Since revised)

44. The chief (internal) audit executive should have direct reporting access to the audit committee, and the committee should oversee the activities and budget of the internal audit function.
ANS: T PTS: 1 DIF: Moderate TOP: Corporate governance responsibilities and failures

45. The internal auditor performs audits of company compliance with company policies and laws, audits to evaluate the efficiency of operations and periodic evaluation and tests of controls.
ANS: T PTS: 1 DIF: Easy TOP: Corporate governance responsibilities and failures

46. The Audit Committee reviews management's performance and determines their remuneration.
ANS: F PTS: 1 DIF: Easy TOP: Corporate governance responsibilities and failures

47. Recent academic research shows that companies with good corporate governance have higher return on equity than other companies.
ANS: T PTS: 1 DIF: Moderate TOP: Importance of good governance to the audit

48. The accounting standards (AASBs) provide the framework for the audit opinion formulation process.
ANS: F PTS: 1 DIF: Moderate TOP: Framework pronouncements

49. One purpose of the planning meeting is to assist the auditor to develop an understanding of key accounting issues and assumptions that affect the preparation of the financial statements.
ANS: T PTS: 1 DIF: Moderate TOP: Phase II: Understanding the client

50. The concept of materiality is pervasive and guides the nature and extent of auditing the financial report.
ANS: T PTS: 1 DIF: Moderate TOP: Phase II: Understanding the client

51. If the evidence does not support a fair presentation, the auditor will continue with the audit of the other accounts.
ANS: F PTS: 1 DIF: Easy TOP: Phases III and IV: Obtaining

evidence

MULTIPLE CHOICE

1. Corporate governance is a process by which the owners and creditors of an organisation:
   a. exert control
   b. require accountability
   c. exert control and require accountability
   d. neither exert control nor require accountability

   ANS: C PTS: 1 DIF: Easy TOP: Corporate governance and auditing

2. Shareholders require accountability from management for:
   a. financial performance
   b. financial transparency
   c. quality of internal controls
   d. all of these choices

   ANS: D PTS: 1 DIF: Easy TOP: Corporate governance and auditing

3. The responsibility for operating an enterprise is delegated to the:
   a. auditor
   b. audit committee
   c. management
   d. board of directors

   ANS: C PTS: 1 DIF: Easy TOP: Corporate governance and auditing

4. Shareholders provide effective oversight through:
   a. auditor appointment
   b. approval of major initiatives
   c. election of board members
   d. all of these choices

   ANS: A PTS: 1 DIF: Moderate TOP: Corporate governance and auditing

5. Governance demands accountability back through the system to the:
   a. shareholders
   b. audit committee
   c. management
   d. all of these choices

   ANS: A PTS: 1 DIF: Moderate TOP: Corporate governance and auditing

6. The audit client of the accounting firm is:
   a. management
   b. the ASX
   c. the audit committee
   d. the shareholders

   ANS: C PTS: 1 DIF: Moderate TOP: Corporate governance responsibilities and failures

7. In response to the corporate failures early in this century the CLERP 9 Act was enacted, in part, to address fundamental problems in:
   a. corporate governance
   b. internal audit functions
   c. manufacturing
   d. all of these choices

   ANS: A PTS: 1 DIF: Moderate TOP: Corporate governance responsibilities and failures

8. The audit committee has oversight responsibilities for:
   a. outside reporting
   b. internal auditing
   c. external auditing
   d. all of these choices

   ANS: D PTS: 1 DIF: Moderate TOP: The CLERP 9 Act 2004 and the ASX Corporate Governance Guidelines (2003) (Since revised)

9. Which of the following should be communicated by the auditor to the audit committee?
   a. all deficiencies in internal control
   b. all audit adjustments
   c. all accounting policies
   d. all significant accounting and audit issues

   ANS: D PTS: 1 DIF: Moderate TOP: Required audit firm communication to the audit committee

10. Which one of the following will provide auditing standards of public companies?
    a. AASB
    b. CPA
    c. GAAP
    d. AUASB

    ANS: D PTS: 1 DIF: Easy TOP: Framework pronouncements

11. The following are the categories of framework pronouncements adopted by the AUASB *except*:
    a. auditing standards (ASAs)

b. generally accepted accounting principles (GAAP)
c. Standards on Review Engagements (ASREs)
d. Standards on Quality Control (ASQC)

ANS: C PTS: 1 DIF: Moderate TOP: Framework Pronouncements

12. Management of an organisation has the responsibility for all of the following *except*:
    a. accounting principles used in financial reporting
    b. engagement of a qualified auditor
    c. internal control over financial reporting
    d. financial statements and disclosures

    ANS: B PTS: 1 DIF: Difficult TOP: The CLERP 9 Act 2004 and the ASX Corporate Governance Guidelines (2003) (Since revised)

13. CLERP 9 Act requires management (both CEO and CFO) to certify:
    a. independence
    b. honesty
    c. competence
    d. accuracy of the financial reports

    ANS: D PTS: 1 DIF: Moderate TOP: The CLERP 9 Act 2004 and the ASX Corporate Governance Guidelines (2003) (Since revised)

14. The board's fundamental objective should be to:
    a. ensure the financial statements are free from all error
    b. ensure management's interests are properly reflected in the strategy of the company
    c. build long-term sustainable growth in shareholder value for the corporation
    d. ensure the organisation is run according to the organisation's constitution with proper accountability

    ANS: D PTS: 1 DIF: Moderate TOP: Corporate governance responsibilities and failures

15. The corporate governance responsibilities of management include:
    a. establishing risk management processes
    b. establishing proper internal controls
    c. requiring high ethical standards
    d. all of these choices

    ANS: D PTS: 1 DIF: Easy TOP: Corporate governance responsibilities and failures

16. The auditing standards are set by various regulators to provide assurance to the public that:
    a. audits are conducted in a professional manner
    b. misstatements are prevented
    c. financial results are clearly communicated
    d. all of these choices

ANS: D PTS: 1 DIF: Moderate TOP: Framework pronouncements

17. All of the following groups have responsibility for ensuring proper corporate governance *except*:
    a. shareholders
    b. board of directors
    c. regulatory authorities
    d. all of these choices

ANS: D PTS: 1 DIF: Moderate TOP: Corporate governance responsibilities and failures

18. Governance failures over the past decade related to the shareholders included all of the following *except*:
    a. focus on short-term prices
    b. failure to perform long-term growth analysis
    c. abdication of most responsibilities to management and analysts as long as stock price increased
    d. all of these are failures

ANS: D PTS: 1 DIF: Moderate TOP: Corporate governance responsibilities and failures

19. Governance failures over the past decade related to the external auditor included all of the following *except*:
    a. failure of the external auditor to implement proper internal controls in the financial systems of their clients
    b. promotion of personnel based on ability to sell non-audit products
    c. replacement of direct tests of accounting balances with inquiries, risk analysis and analytics
    d. all of these choices

ANS: A PTS: 1 DIF: Moderate TOP: Corporate governance responsibilities and failures

20. Which group is responsible for ensuring that the organisation is run according to the organisation's charter and that there is proper accountability?
    a. regulatory agencies such as the SEC
    b. external auditors
    c. board of directors
    d. internal auditors

ANS: C PTS: 1 DIF: Easy TOP: Corporate governance responsibilities and failures

21. Specific activities performed by regulatory agencies such as ASIC include the following *except*:
    a. review of filings
    b. conducting quality review inspections of audit firms
    c. auditing the financial statements to express an opinion
    d. monitoring trading activities

    ANS: C PTS: 1 DIF: Moderate TOP: Corporate governance responsibilities and failures

22. Specific activities performed by external auditors include(s):
    a. preparation of client financial statements in conformity with GAAP
    b. services such as audit, tax or consulting
    c. creating and specifying independence standards
    d. all of these choices

    ANS: B PTS: 1 DIF: Moderate TOP: Corporate governance responsibilities and failures

23. Specific activities performed by management include the following *except*:
    a. formulating strategy and risk management
    b. implementing effective internal controls
    c. hiring of the external auditors
    d. all of these choices

    ANS: C PTS: 1 DIF: Easy TOP: Corporate governance responsibilities and failures

24. In the US, SEC Chairman Levitt issued a report citing concerns with the audit process. These concerns included all of the following *except*:
    a. analytical procedures were being used inappropriately to replace direct tests of account balances
    b. audit documentation, especially relating to the planning of the audit, was not in compliance with professional standards
    c. auditors were ignoring warning signals of fraud and other problems
    d. audit firms were thoroughly evaluating internal controls

    ANS: D PTS: 1 DIF: Moderate TOP: Corporate governance responsibilities and failures

25. An audit committee must comprise outside directors and at least one outside financial expert. Which of the following is considered an outside director?
    a. a director who is not a member of management and has no other relationship to the organisation
    b. a consultant to the organisation who works as an honorary member of the board
    c. a director who is also a member of management and has no other relationship to the company

d. a director who is a CPA and CIO of an affiliated organisation

ANS: A PTS: 1 DIF: Moderate TOP: The CLERP 9 Act 2004 and the ASX Corporate Governance Guidelines (2003) (Since revised)

26. Which of the following members of the board of directors of McKeever Corporation is most qualified to serve on McKeever's audit committee?
    a. Jon Adams, internal auditor of McKeever Corporation
    b. Megan Wiley, lawyer to McKeever Corporation
    c. Karen Jones, consultant to McKeever Corporation
    d. none of these choices

ANS: D PTS: 1 DIF: Moderate TOP: The CLERP 9 Act 2004 and the ASX Corporate Governance Guidelines (2003) (Since revised)

27. The audit committee's primary responsibilities related to the financial reporting process include:
    a. providing oversight of the accounting and financial reporting processes
    b. appointing, compensating and overseeing the external auditor
    c. ensuring that the board establishes a whistleblower program
    d. all of these choices

ANS: D PTS: 1 DIF: Easy TOP: The CLERP 9 Act 2004 and the ASX Corporate Governance Guidelines (2003) (Since revised)

28. It is expected that the external auditor report the following to the audit committee *except*:
    a. critical accounting policies and practices used by management.
    b. materiality methodology and thresholds used by the auditor.
    c. material alternative GAAP treatments that have been discussed with accounting
    d. material written communications between the auditor and management.

ANS: B PTS: 1 DIF: Difficult TOP: Overview of the audit and review processes: A standards-based approach

29. Which of the following member of the Robbins Corporation Board of Directors should not serve on the audit committee?
    a. John Williams, professor at the University of Kalamazoo
    b. Tyrone Marks, accountant of Robbins Corporation
    c. Stacy Bobbitt, member of the board of directors of the First National Bank and Trust
    d. Jill Cemoss, chairman of the board of Big Brothers and Sisters, a non-profit organisation

ANS: B PTS: 1 DIF: Moderate TOP: The CLERP 9 Act 2004 and the ASX Corporate Governance Guidelines (2003) (Since revised)

30. The audit committee's major areas of responsibility include all of the following *except*:
    a. oversight of the internal control system

b. oversight of the internal audit function and external auditor
c. preparation of financial statements
d. establishment and oversight of a whistleblower process

ANS: C PTS: 1 DIF: Easy TOP: The CLERP 9 Act 2004 and the ASX Corporate Governance Guidelines (2003) (Since revised)

31. The lead engagement and review partner must rotate every:
a. two years
b. three years
c. four years
d. five years

ANS: D PTS: 1 DIF: Easy TOP: The CLERP 9 Act 2004 and the ASX Corporate Governance Guidelines (2003) (Since revised)

32. The Board of Directors carry out the following specific activities *except*:
a. declaring dividends
b. selecting management
c. managing and reviewing operations
d. approving major changes, e.g. mergers

ANS: C PTS: 1 DIF: Difficult TOP: Corporate governance responsibilities and failures

33. The audit committee should perform the following in relation to the management of the external auditor:
a. hiring
b. firing (if appropriate)
c. determining the audit fee
d. all of these actions should be performed

ANS: D PTS: 1 DIF: Moderate TOP: The CLERP 9 Act 2004 and the ASX Corporate Governance Guidelines (2003) (Since revised)

34. The audit committee should disclose the processes it uses in discharging its responsibilities, including all of the following *except*:
a. the number of meetings each year
b. how the committee oversees the internal audit function
c. committee activities performed to assess the risk of fraudulent financial reporting
d. the committee's role in its direct implementation of internal controls

ANS: D PTS: 1 DIF: Difficult TOP: Corporate governance responsibilities and failures

35. In the US, the *Sarbanes-Oxley Act of 2002* requires which of the following?
a. only the largest four accounting firms may audit public companies
b. smaller public companies that cannot afford to become compliant with the Act

must delist and become pink sheet companies
c. all publicly held companies will provide a report on internal control over financial reporting
d. chief financial officers of public companies must be CPAs

ANS: C PTS: 1 DIF: Moderate TOP: Framework pronouncements

36. Standards are similar in key areas including:
a. planning the audit to minimise risk
b. audit evidence
c. nature of the audit
d. all of these choices

ANS: D PTS: 1 DIF: Easy TOP: Framework pronouncements

37. The AUASB is under the strategic direction of:
a. FRC
b. ASX
c. ASIC
d. GAAP

ANS: A PTS: 1 DIF: Difficult TOP: Framework pronouncements

38. Brooklyn Mercantile Inc., a public company, receives audit services from Gregory and Elder, LLC. Brooklyn Mercantile Inc. may engage Gregory and Elder to perform corporate tax returns only if:
a. Gregory and Elder is registered with the ASIC
b. Gregory and Elder is independent of Brooklyn Mercantile Inc. for tax purposes
c. tax services by Gregory and Elder are approved by Brooklyn Mercantile Inc.'s audit committee
d. ASIC approves such 'non-audit' services in writing

ANS: C PTS: 1 DIF: Difficult TOP: Corporate governance responsibilities and failures

39. Following the Ramsay Report (2002) which of the following was recommended for the responsibility for corporate governance recommendations?
a. ASIC
b. CPA
c. ASX
d. IASB

ANS: C PTS: 1 DIF: Moderate TOP: The CLERP 9 Act 2004 and the ASX Corporate Governance Guidelines (2003) (Since revised)

40. The purpose of the planning meeting includes developing an understanding of:
a. materiality
b. the scope of the audit services to be performed

c. management's preparedness
d. all of these choices

ANS: D PTS: 1 DIF: Moderate TOP: Phase II: Understanding the client

41. The development of a detailed audit program is primarily designed to discover:
a. operational efficiencies
b. off-balance sheet transactions
c. fraud
d. material misstatements

ANS: D PTS: 1 DIF: Moderate TOP: Phase II: Understanding the client

42. The auditing standards require the auditor to gather:
a. accounting records
b. official correspondence
c. bank reconciliations
d. sufficient, appropriate evidence

ANS: D PTS: 1 DIF: Easy TOP: Phases III and IV: Obtaining evidence

43. Audit programs are based on which following fundamental?
a. Audit procedures reflect a thorough understanding of the underlying assertions.
b. Audit procedures are adjusted for the risk of potential misstatement in the account balance.
c. There are many factors that influence the risk of misstatement.
d. all of these choices

ANS: A PTS: 1 DIF: Moderate TOP: Phase II: Understanding the client

44. A proper system of corporate governance is one that demands:
a. decision making by auditors in place of management
b. accountability back through the system to the shareholders
c. internal audit representation on the board of directors
d. audit planning to obtain competent and sufficient audit evidence

ANS: B PTS: 1 DIF: Easy TOP: Corporate governance and auditing

45. The auditor may properly address the risk associated with an organisation that does not demonstrate a commitment to good governance in the all of the following ways *except*:
a. not accepting the client
b. performing more audit work to better manage the financial risk to the auditor

c. charging a higher audit fee without performing increased audit work to compensate the auditor for the risk
d. all of these choices

ANS: C PTS: 1 DIF: Difficult TOP: Importance of good governance to the audit

46. Companies with good governance generally have the following characteristic(s):
a. they are less likely to engage in ‘financial engineering’
b. they take the requirements of good internal control over financial reporting seriously
c. they make a commitment to financial competencies needed
d. all of these choices

ANS: D PTS: 1 DIF: Moderate TOP: Importance of good governance to the audit

ESSAY

1. **The role of the auditor and the audit committee**

Describe the relationship between the external auditor and the audit committee of the company receiving audit services.

ANS:

The audit committee hires the auditor to perform audits of financial statements that are the representations and responsibilities of management. The audit committee is the literal client of the auditor. The audit committee has the responsibility to assess the quality of audit services received, including the independence of the external audit firm. The audit committee has the ultimate ability to fire the audit firm.

According to ASA 260 and ASA 265 of the auditing standards, the auditors must communicate specific issues to the audit committee. These items of communication include:

– significant deficiencies in internal control
– the client company’s adoption of significant accounting policies and principles
– the client company management’s judgements and estimates of certain accounting balances
– significant audit adjustments proposed by the auditors
– all major accounting disagreements with management whether or not resolved.

PTS: 1 DIF: Moderate TOP: Required audit firm communication to the audit committee

2. **Characteristics of an effective audit committee**

List and discuss at least four activities of an effective audit committee that provides important oversight functions.

ANS:

Attributes of an effective audit committee includes:

– nominating external audit firm
– signing off to board that non-audit work performed by the audit firm does not compromise independence
– selecting and/or approving the appointment of the Head of Internal Audit position
– reviewing and approving the scope and budget of the internal audit function
– discussing audit findings with internal auditor and external auditor and advising the board (and management) on specific actions that should be taken

DIF Easy TOP: Corporate governance responsibilities and failures

3. **Corporate governance overview**

Discuss what corporate governance is and briefly describe an overview of the corporate governance process.
ANS:
Corporate governance is defined as ‘a process by which the owners and creditors of an organisation exert control and require accountability for the resources entrusted to the organisation. The owners (shareholders) elect a board of directors to provide oversight of the organisation’s activities’.

Responsibility runs down the organisation. Governance starts with the shareholders/owners delegating responsibilities through an elected board of directors to management and, in turn, to operating units with oversight and assistance from internal auditors. Accountability runs upward in the organisation. Operations personnel are held responsible for their actions and decisions by management, management has to account for their decisions and actions to the board of directors, and both the board and management are held accountable by the shareholders.
PTS: 1 DIF: Easy TOP: Corporate governance and auditing

4. **Auditor’s independence**

Discuss the more significant provisions of the CLERP 9 Act provisions that deal with the auditor’s independence.
ANS:
The CLERP 9 Act provisions dealing with auditor’s independence included requirements to:
• include a general statement of principle requiring the independence of auditors (S324CA)5
• require the auditor to make an annual declaration, addressed to the board of directors, that the auditor has maintained its independence in accordance with the Act and the rules of the professional accounting bodies (S307C)
• strengthen restrictions on employment relationships between an auditor and audit client. This includes a mandatory period of two years following resignation from an audit firm before a former partner directly involved in the audit of a client can become a director of the client or take a position with the client involving responsibility for fundamental management decisions

(S324CI)
• impose new restrictions on financial relationships. This covers investments in audit clients and loans between an audit client, and the auditor or their immediate family (S324CH)
• require mandatory disclosure in the annual report of fees paid for not just non-audit services (NAS) but, for the first time, the categories of NAS provided6 (S300(11Ba))
• require a statement in the annual report of whether the board of directors is satisfied that the provision of NAS is compatible with auditor independence (S300(11Ba)). This disclosure includes an explanation as to why the following non-audit services, if contracted, do not compromise audit independence:
a preparing accounting records and financial statements of the audit client
b valuation services
c internal audit services
d IT systems services
e temporary staff assignments
f litigation support services
g legal services
h recruitment of senior management for the audit client
i corporate finance and similar activities
• make audit lead engagement and review partner rotation compulsory after five years (S324AD);
with provision for ASIC (S342A) to grant relief where necessitated by circumstances
• require accountants seeking registration as company auditors to meet agreed competency standards, to undertake to abide by an accepted code of professional ethics and to complete a specialist auditing course prior to registration (S1280A).

PTS: 1 DIF: Moderate TOP: CLERP 9 and ASX Governance