

## Chapter 2

### End of Chapter Material

#### Multiple Choice Questions

1. The goal of an audit of financial statements (i.e., a GAAS audit) is:
  - a. Prevention and detection of fraud and error.
  - b. Ensure the financial statements are in accordance with accounting standards.
  - c. Evaluate the likelihood that an organization will continue as a going concern.
  - d. All of the above.
  - e. None of the above.
  
2. The major auditing standards setters in the world are:
  - a. Public Company Accounting Oversight Board and the International Audit and Assurance Standards Board.
  - b. International Accounting Standards Board and the Financial Accounting Standards Board.
  - c. United Nations and the European Union.
  - d. The Big Four audit firms.
  - e. None of the above.
  
3. The relationship with internal control over financial reporting and enterprise risk management is:
  - a. Internal control over financial reporting is a subset of the controls of interest to enterprise risk management.
  - b. Internal control over financial reporting is unrelated to the controls of interest to enterprise risk management.
  - c. Internal control over financial reporting and enterprise risk management both are focused on the quality of information provided by the organization about its finances.
  - d. None of the above.
  
4. The major difference in focus between enterprise risk management and internal control over financial reporting is that:
  - a. Internal control over financial reporting focuses on strategic management and objective setting in the organization whereas enterprise risk management focuses on risk.

- b. Enterprise risk management focuses on a broader set of risks, including strategic and objective setting, than the set of risks focused on by internal control over financial reporting.
  - c. There is no overlap in focus between enterprise risk management and internal control over financial reporting.
  - d. None of the above.
5. The Integrated Audit refers to an audit that:
- a. Involves both enterprise risk management and internal control over financial reporting.
  - b. Is a GAAS audit that ignores internal controls.
  - c. Examines both the effectiveness of internal controls over financial reporting and the fairness of presentation of the information in the financial statements.
  - d. Is a GAAS audit that relies on internal controls as part of the set of evidence to support the auditors' opinion on the financial statements.
  - e. None of the above.
6. GAAS stands for:
- a. Generally Accepted Accounting Standards.
  - b. General Audit and Accounting Standards.
  - c. Generally Accepted Auditing Standards.
  - d. Group Audit and Accounting Standards.
  - e. None of the above.
7. The US Public Company Accounting Oversight Board sets standards for:
- a. Auditing and accounting in the US for all companies.
  - b. Auditing in the US for all companies.
  - c. Auditing for all public companies registered with the US Securities and Exchange Committee.
  - d. Auditing and accounting for all public companies registered with the US Securities and Exchange Committee.
  - e. Auditors who carry out any audit work in the US.
8. The International Auditing and Assurance Standards Board sets standards that:
- a. Are without the force of law unless a national or regional governmental organization or regulator adopts them as standards for audits of organizations in that country or region.
  - b. Are recognized by the European Union for audits of all companies in Europe.

- c. Are reviewed by the United Nations and adopted by vote of the General Assembly.
- d. Sets auditing standards that have force of law for all public companies that are not registered with the US SEC.
- e. None of the above.

9. COSO's Internal Control-Integrated Framework is:

- a. Established by the Public Company Accounting Oversight Board.
- b. Used by companies around the world to evaluate their internal controls, especially their internal controls over financial reporting.
- c. Part of COSO's Enterprise Risk Management framework.
- d. Required to be employed by all public companies registered with the US SEC to evaluate their internal controls over financial reporting.
- e. None of the above.

10. Risks can be:

- a. Assessed, managed, and monitored.
- b. Identified, audited, and measured.
- c. Controlled, accounted for, and reported on.
- d. Transferred, shared, and audited.
- e. None of the above.

11. Key aspects of ethical standards for auditors include:

- a. Objectivity, independence, and integrity.
- b. Leadership, human resources, and monitoring.
- c. Conduct, fieldwork or examination, and reporting.
- d. Assessment, management, and monitoring.
- e. None of the above.

12. Professional skepticism means that the auditor must:

- a. Not accept anything that the client managers say at face value.
- b. Be unfriendly toward client management.
- c. Be objective, critical, and have a questioning mind about what client managers say.
- d. Careful to let personal appearance of client managers not affect his relationship with them.
- e. None of the above.

13. Actions that would clearly mean that the auditor is not independent include:
- a. Having a financial interest in the client.
  - b. Being related to the senior vice president of the client firm.
  - c. Preparing and making entries into the client's accounting records.
  - d. All of the above.
  - e. None of the above.
14. Accepting tickets to a sporting event from client management would be considered a violation of:
- a. Independence in appearance.
  - b. Independence in mind or fact.
  - c. Gifts and hospitality ethical standard.
  - d. Both independence in appearance and independence in mind or fact.
  - e. Neither independence in appearance nor independence in mind or fact.
15. GAAP refers to:
- a. Generally Accepted Auditing Principles.
  - b. Generally Accepted Accounting Principles.
  - c. General Authoritative Accounting Principles.
  - d. General Audit and Accounting Principles.
  - e. None of the above.
16. The reporting of an auditor involves:
- a. Prevention, detection, and reporting of fraud or errors.
  - b. Assertions examined, measurement and financial reporting criteria, and overall conclusions.
  - c. Identification, measurement, and reporting on the overall financial health of an organization.
  - d. Identifying controls, financial statements, and reporting errors found in them.
  - e. None of the above.

### Questions

1. How do enterprise risk management (ERM) and corporate governance relate? Use the components of the COSO ERM framework to illustrate your answer.
2. What are the five elements of COSO's Internal control framework over financial reporting? Provide a definition for each element and give a brief example of how this function can be applied to a community bank.
3. Compare and contrast auditing and monitoring (using the COSO definition of monitoring).
4. Explain the audit implications of the dynamic relationship between strategy and internal control.
5. Control environment is a component of internal control according to the COSO framework. Describe how the control environment may also affect the audit.
6. A study on fraud by Beasley et al. (1999), which was commissioned by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), found that in 84 percent of the frauds investigated, either the president, chief financial officer, or both were aware of or actively contributed to the fraud. Discuss how auditors should use this information when designing audit procedures to examine the control environment of an organization. How might auditors better assure themselves that they are not involved with a client where an executive fraud is occurring?
7. Describe the differences between a GAAS Audit and an Integrated Audit (i.e., audit of a public company registered in the US with the Securities and Exchange Commission).
8. What is internal control as defined by COSO's Internal Control-Integrated Framework? How does it differ from the concept of internal control as discussed in the COSO's Enterprise Risk Management—Integrated Framework?