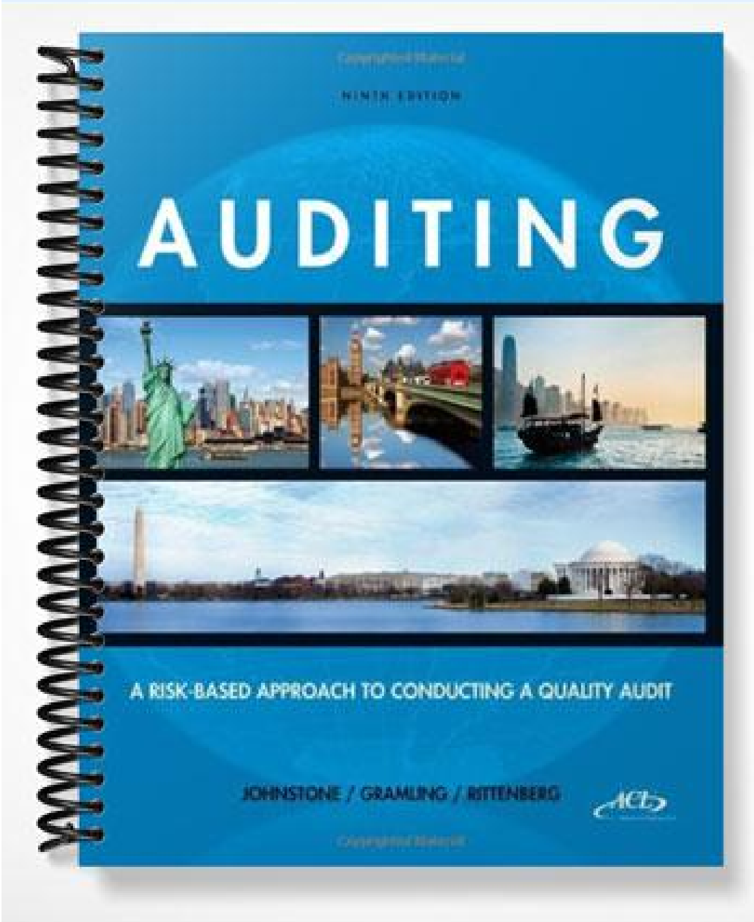
TEST BANK


NINTH EDITION
AUDITING
A RISK-BASED APPROACH TO CONDUCTING A QUALITY AUDIT
JOHNSTONE / GRAMLING / RITTENBERG

Chapter 2: The Risk of Fraud and Mechanisms to Address Fraud: Regulation, Corporate Governance, and Audit Quality

Student: ____

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29. According to the PCAOB, the detection of material fraud is a reasonable expectation of users of audited financial statements.

True False

30. One fraud risk factor includes the presence of domineering members of management who seek the ultimate loyalty of subordinates.

True False

31. The audit team should develop its own ideas about how fraud may be performed by the client and then covered up.

True False

32. Audit tests do not relate to fraud testing because testing for fraud is conducted in a separate engagement.

True False

33. When the risk of fraud is high in financial statements, the auditor should assign less experienced auditors to the engagement.

True False

34. Various types of ways that fraud could be perpetrated should be hypothesized by the auditor prior to conducting audit testing.

True False

35. When fraud risk is great in the organization under audit, procedures applied are likely to be more extensive.

True False

36. Material fraud perpetrated by management must always be reported by the auditor to the SEC.

True False

37. During the time period of 1998 to 2007, the median size of public company perpetrating fraud rose tenfold to $100 million (as compared to the previous ten years).

True False

38. According to COSO studies, the majority of the frauds took place at companies that were listed on the Over-The-Counter (OTC) market, rather than those listed on the NYSE or NASDAQ.

True False

39. Auditors are responsible to fraud even if it has an immaterial effect on the financial statements.

True False

40. The landmark Enron fraud in the early 2000's involved the movement of significant debt off the books to related, unconsolidated entities.

True False

41. Successful corporate governance depends upon successful management of the company, as management has the primary responsibility for creating a culture of performance with integrity and ethical behavior.

True False

42. Transparency is a desirable, but not critical, element of effective corporate governance.

True False

43. The auditor has a responsibility to design the audit to provide absolute assurance of detecting material fraud.

True False

44. When preliminary fraud risk is high the auditor should pay close attention to areas of the audit that are highly subjective and should increase the predictability of the audit procedures.

True False

45. The auditor can be satisfied with less than persuasive evidence in the audit process because of the belief that management is honest.

True False

46. Professional skepticism involves such things as questioning and corroborating management responses to inquiries and determining the authenticity of documents.

True False

47. The objective of financial reporting is to provide useful information to interested users.

True False

48. Corporate governance is a process by which the owners, but not the creditors, exert control and require accountability for the resources entrusted to the organization.

True False

49. The audit committee is a subcommittee of the board of directors comprised of independent outside directors.

True False

50. The auditor must communicate significant audit adjustments to the audit committee.

True False

51. Any major disagreement the auditor has with management should be discussed with the audit committee.

True False

52. Managers of organizations are hired by Boards of Directors to perform responsibilities such as the implementation of internal control.

True False

53. An audit must be performed by persons who can make sound judgments relating to complex accounting issues.

True False

54. The audit committee must be composed of outsiders such as the organization's attorney and audit partner.

True False

55. Management of companies should have the ability to hire and fire the external auditor.

True False

56. The audit committee should have the authority to hire and fire the external auditor.

True False

57. Auditors are required to inform the audit committee of any significant audit adjustments discovered during the engagement.

True False

58. Audit committees of publicly traded companies must establish whistleblowing mechanisms within the company.

True False

59. Why is fraud detection an important part of the audit?

A. Auditors are required to seek out and find all fraud, regardless of its magnitude.
B. Auditors expect that management will make them aware of any fraud in the financial statements.
C. Society expects that financial statements have not been materially misstated due to fraud.
D. Society realizes that some fraud was not intended to be discovered by auditors.

60. Which of the following statements about fraud is true?

A. Unless auditors can provide assurance that the financial statements are free of material misstatements due to fraud, there is no justification for the audit function.
B. The AICPA has mandated that the auditor take on more responsibility than previously required because of management's demand for fraud detection.
C. It is the responsibility of the auditor to provide internal control over a client organization sufficient to discover or prevent fraud from occurring.
D. Auditor-initiated fraud is a large concern of shareholders and the audit committee must continually monitor the auditors to ensure they are not misstating financial statements.

61. Which of the following represents the size of company that has historically committed fraudulent financial reporting or that has experienced asset misappropriation by its employees?

A. Large corporations.
B. Middle-market corporations.
C. Small and start-up companies.
D. All companies.

62. What is the primary determinate in the difference between fraud and errors in financial statement reporting?

A. The materiality of the misstatement.
B. The intent to deceive.
C. The level of management involved.
D. The type of transaction affected.

63. Which of the following statements reflects an auditor's responsibility for detecting fraud?

A. An auditor is not responsible for discovering fraudulent acts involving employee collusion.
B. The audit should be planned to detect fraud caused by departures from GAAP.
C. An auditor is only responsible for detecting fraudulent financial reporting.
D. An auditor should design the audit to provide reasonable assurance of detecting errors and fraud that are material to the financial statements.

64. Which of the following best represents fraudulent financial reporting?

A. The transfer agent issues 40,000 shares of the company's stock to a friend without authorization by the board of directors.
B. The controller of the company decreases warranty expense by $3 million because the company will otherwise miss analysts' expectations this quarter.
C. The in-house attorney receives payments from the French government for negotiating the development of a new plant in Paris.
D. The accounts receivable clerk covers up the theft of cash receipts by writing off older receivables without authorization.

65. According to professional auditing standards, which of the following **best** represents a type of fraudulent financial reporting?

A. Management accrues a liability and discloses the possible outcome of a lawsuit prior to settling the matter.
B. Management reclassifies a negative cash balance by increasing cash and also increasing a current liability.
C. Management discloses its failure to meet loan covenants but states that a waiver has been received.
D. Management intentionally excludes a subsidiary from its consolidated results that it controls significantly.

66. What type of fraud occurs when the deposits of current investors are used to pay returns on the deposits of previous investors with no real investment happening?

A. Skimming.
B. Ponzi Scheme
C. Channel Stuffing.
D. Payroll Fraud.

67. Which of the following is most likely considered an omission from financial statement reporting?

A. The company no longer discloses a contingency because it was settled previously.
B. The company does not present goodwill because it was impaired currently.
C. The company does not disclose earnings per share because it is privately held.
D. The company does not present a statement of cash flows because of its current net loss.

68. Which of the following is the most common type of fraudulent financial reporting?

A. Capitalizing major overhauls to operating equipment.
B. Deferring service revenue until it is delivered to customers.
C. Including as sales inventory sold with the right to return.
D. Excluding a contingent liability that has been settled.

69. Which of the following best represents an example of fraud utilizing the lapping technique?

A. An employee transfers cash on the last day of the year in order to double record it in the bank accounts.
B. An employee creates a fictional vendor and requests payment to a personal P.O. box.
C. An employee opens the mail to cover up payroll fraud received on a fictional person.
D. An employee covers up the stealing of receipts by posting to the wrong customer accounts.

70. Which is not an example of the theft of accounts receivable?

A. Recording discounts to customers, stealing the cash, and then reducing accounts receivable for the amount of cash stolen.
B. Creating fictional invoices and customers and recording accounts receivable.
C. Writing off accounts receivable as uncollectible to hide receipts taken.
D. Posting upcoming payments to the account of a customer whose most recent payment was diverted.

71. Who is most often involved in perpetrating fraudulent financial reporting?

A. The auditors and the attorneys.
B. The treasurer and the board of directors.
C. The chief executive and chief financial officers.
D. The shareholders and the chief operating officer.

72. What is the best way an auditor can detect fraud in the financial statements?

A. Use professional skepticism.
B. Understand Generally Accepted Accounting Standards.
C. Brainstorm with the client to find the types of fraud occurring.
D. Actively search for errors in the financial statements.

73. How must an auditor address fraud in the planning stage?

A. The auditor must test for fraud in the planning stage by sampling accounts.
B. The auditor must consider the likelihood of fraud existing in the company in the planning stage.
C. The auditor must realize that most people are honest and not automatically assume that fraud exists when planning the audit.
D. The auditor must not be aggressive in its initial approach to fraud as trust may be lost by the client.

74. What should an audit team do when it discovers that fraud risk factors are present on an audit engagement?

A. Retract from the client and inform regulatory bodies.
B. Modify procedures to actively search for the existence of fraud.
C. Reduce the amount of evidence required and resort to management inquiry.
D. Turn the audit over to forensic accountants.

75. The fraud triangle says three conditions are generally present in the client's organization when fraud occurs. Which of the following is not one of those conditions?

A. Incentives.
B. Professional Skepticism.
C. Opportunity.
D. Ability to rationalize fraud.

76. Which of the following best represents actions that may indicate fraud is pervasive throughout the company under audit?

A. The company's management negotiates deals with vendors in such a manner as to pay lower prices.
B. The company's management drives luxury vehicles and takes vacations to exotic places.
C. The company's management takes an overly aggressive approach to revenue recognition.
D. The company's management estimates bad debts using an aged accounts receivables ledger rather than as a percent of sales.

77. Which of the following best describes professional skepticism?

A. An intent to deceive.
B. An attitude of intrusion and obstinacy.
C. A character that does not waver.
D. A questioning mind.

78. According to professional audit standards, how might an understanding of the nature of fraud that may occur in the client organization be identified by an audit firm?

A. Fraud training courses from actual corporate fraud ex-criminals.
B. Conducting a brainstorming session with the members of the audit team.
C. Circulating a survey to the client company employees for completion.
D. Discussions with other audit firms.

79. Which of the following situations represents a risk factor that relates to misstatements arising from misappropriation of assets?

A. A high turnover of senior management.
B. A lack of independent checks.
C. A strained relationship between management and the predecessor auditor.
D. An inability to generate cash flow from operations.

80. The Center for Audit Quality (CAQ) report identifies which of the following ways in which individuals involved in the financial reporting process can mitigate the risk of fraudulent financial reporting?

A. Individuals involved in financial reporting need to acknowledge that there needs to exist a strong, highly ethical tone at the top of an organization that permeates the corporate culture, including an effective fraud risk management program.
B. Individuals involved in financial reporting need to continually exercise professional skepticism.
C. Individuals involved in financial reporting need to remember that strong communication among those involved in the financial reporting process is critical.
D. All of the above.

81. Which of the following frauds is most common?

A. Chief financial officer misappropriation of funds.
B. Misapplication of revenue recognition principles.
C. Management's theft of cash held in reserve accounts.
D. Over-recording expenses related to stock options.

82. Which of the following is an example of fraud?

A. A mistake in processing accounting data.
B. An incorrect accounting estimate arising from misinterpretation of facts.
C. Misappropriation of an asset.
D. A mistake in the application of accounting principles.

83. How will the results of the auditor's assessment of fraud risk factors affect the planned audit procedures?

A. Audit procedures and fraud assessment do not relate.
B. The assessment may require a re-audit of previous periods.
C. Qualified audit staff will be assigned to relevant areas of the engagement.
D. Management will be called upon to assist in coordinating audit procedures.

84. When is the assessment of fraud risk complete?

A. Upon completion of the planning stage.
B. Once internal control is understood.
C. Only after the audit risk model has been used to design tests.
D. Once the audit is complete.

85. Protection Transparency, Inc. is being audited by Messer and Bromely, LLP. During the assessment of fraud, Messer and Bromely discover that the controller has been creating fictional sales and posting them to the general ledger. Who should the auditors make aware of this issue?

A. Protection Transparency's legal counsel.
B. The police.
C. The chairman of Protection Transparency's audit committee.
D. The predecessor auditor of Protection Transparency.

86. Management of Premium Discovery Company is compensated through large salaries, stock options and bonuses tied to the company's working capital growth. The CEO is constantly holding meetings to ensure that management is on target for increased operating income each month. Based upon the above information only, what type of probable motivation is there to commit fraud at the Premium Discovery Company?

A. Incentive.
B. Opportunity.
C. Rationalization.
D. Expectation.

87. Which of the following creates an opportunity for fraud to be committed in an organization?

A. Management demands financial success.
B. Poor internal control.
C. Commitments tied to debt covenants.
D. Management is aggressive in its application of accounting rules.

88. Which of the following statements about the Bernie Madoff ponzi scheme is false?

A. Madoff too advantage of his unique ties to the investment community (he was the former Chair of the NASDAQ) to create trust and encourage further investments.
B. Madoff began perpetrating the fraud shortly before passage of the Sarbanes-Oxley Act, and the provisions of that Act ultimately led to discovery of the fraud.
C. Madoff was sentenced to 150 years in prison.
D. The estimated amount missing from client accounts, including fabricated gains, was almost $65 billion.

89. Sam Jones, controller of Mitnikco, spends three days researching the accounting statements to find loopholes in the "rules" and to make a case for recognizing revenue earlier, rather than in later years. In the end, Sam and the other members of management determine that they will reduce the company's deferred revenue accounts and begin accounting for all revenues as agreements are signed. What are the motivations of Mitnikco management based solely on the information above?

A. Pressures.
B. Opportunity.
C. Rationalization.
D. Skepticism.

90. There are many important reasons to diligently plan for an audit. If an audit firm wrongly skips the planning stage of an audit, what will be effect relative to fraud detection?

A. The firm will not be able to apply GAAP to the financial statements.
B. The firm will not adequately identify the types of fraud that may occur in the client company.
C. The firm will not be able to perform direct tests of account balances.
D. The firm will lack the competency and technical training necessary to complete the audit in accordance with GAAS.

91. Which of the following statements about fraud or fraud detection is true?

A. Management may physically alter evidence to perpetrate and conceal the fraud.
B. Most fraudulent financial reporting is not material enough to consider.
C. Journal entries do not supply evidence necessary to detect fraud.
D. The advent of new technology prevents fraud, thereby leading to less fraud over time.

92. How did the Sarbanes-Oxley Act strengthen auditor independence?

A. By requiring auditors to provide reports in accordance with the Foreign Corrupt Practices Act.
B. By requiring auditors to report the nature of any auditor-client disagreements to the SEC.
C. By requiring audit committees to appoint the auditors.
D. By requiring a different audit firm from the one that performs the audit to prepare the client's tax return.

93. Which of the following frauds involved primarily asset misappropriation?

A. Enron.
B. Worldcom.
C. Dell.
D. Koss.

94. Which of the following factors should an auditor consider in evaluating the effect of fraud upon the planned audit procedures?

A. The type of fraud that may occur.
B. The potential materiality of fraud.
C. The likelihood of fraud occurring.
D. All of the above.

95. The audit team asks management for original documents related to sales contracts. Despite the team's persistence, management does not supply the documents for over two weeks. What should this audit team be most concerned with as it relates to these documents?

A. The need to complete the audit within a specified period of time.
B. Management's possible use of the time to fabricate the documents.
C. Discrepancies of the evidence.
D. Conflicting evidence.

96. Who should the auditors first notify if they discover a material fraud?

A. The PCAOB.
B. The SEC.
C. The management of the company.
D. The audit committee of the company.

97. Who should the auditors first notify if they discover a material misappropriation of assets?

A. The PCAOB.
B. The SEC.
C. The management of the company.
D. The audit committee of the company.
E. They are not required to notify anyone.

98. Which of the following statements best describes the outcome of the auditor discovering fraud in the financial statements?

A. The outcome will depend on the type of the fraud, along with its materiality.
B. Management must disclose any and all fraud directly in the footnotes.
C. The auditor is required to include a full description of the fraud in the audit report to the financial statements.
D. There is no bearing on the financial statements by fraud that is discovered by the auditor.

99. If management makes appropriate adjustments to correct the implications of a fraud discovered in a financial statement audit, but does not take appropriate steps to modify internal controls, upon what does this have a direct impact?

A. The auditor's opinion on the financial statements.
B. The client's executive compensation.
C. The auditor's perception of the overall control environment.
D. All previous work performed by the auditor on this client.

100. In considering corporate governance responsibilities and accountabilities, which of the following are considered stakeholders to whom the board of directors, management, and internal auditors are accountable?

A. Shareholders/owners.
B. External auditors.
C. Regulators.
D. Both A and C.
E. All of the above.

101. Which of the following represents fraud procedures used by auditors?

A. The auditor must disregard complex transactions for reasons of economic substance.
B. The auditor cannot allow the client to pressure the timing of the audit for early release of earnings.
C. The auditor must put less emphasis on capital additions and more on payroll.
D. The auditors must no longer use confirmations and move forward to internal verification.

102. Which of the following items are registered audit firms <u>not</u> required to report to the audit committee?

A. Critical accounting policies and practices.
B. Alternative treatments of financial information within generally accepted accounting principles that have been considered by management, as well as the preferred treatment of the audit firm.
C. A list of all audit procedures performed.
D. Significant written communications between the audit firm and management.

103. Which of the following is <u>not</u> one of the components of the fraud risk model?

A. Incentive.
B. Rationalization.
C. Susceptibility.
D. Auditors do not use a fraud risk model.

104. A common accounts receivable fraud is lapping. Which of the following is a more sophisticated accounts receivable fraud?

A. Using journal entries to write off accounts against the allowance for doubtful accounts.
B. Applying cash from one customer's receivable to that of another to cover the earlier deficit.
C. Recording large discounts for the clients.
D. Both A and C.

105. The fraud triangle has three components. Which of the components must be present for a fraud to occur?

A. All factors must be present for fraud to occur.
B. All factors need not be present.
C. Fraud can occur if any one of the factors is present.
D. None of the above

106. Which of the following best describes how corporate governance influences an organization?

A. To exert control over management.
B. To hold management accountable for its actions.
C. To exert control over management and hold management accountable for its actions.
D. To neither exert control over management or hold management accountable for its actions.

107. Who is responsible for operating an enterprise?

A. The auditor.
B. The audit committee.
C. Management.
D. The board of directors.

108. Who is the client in an audit engagement?

   A. Management.
   B. The SEC.
   C. The audit committee.
   D. The stockholders.

109. Which of following best describes the audit committee's oversight responsibility?

   A. Provide oversight of reporting outside the organization.
   B. Provide oversight of internal auditing function.
   C. Provide oversight of the external audit.
   D. All of the above.

110. Which of the following facts should be communicated by the auditor to the audit committee?

   A. The auditor's responsibilities under GAAP.
   B. All significant audit adjustments.
   C. Significant accounting policies.
   D. All are required communications.

111. Which of the following is not one of management's responsibilities?

   A. Ensuring accounting principles are following in preparing financial statements.
   B. Engaging a qualified auditor.
   C. Implementing effective internal controls.
   D. Ensuring financial statements and disclosures are accurate.

112. Which of the following best describes management responsibilities under the Sarbanes-Oxley Act of 2002?

   A. Certify the accuracy of financial statements.
   B. Establish a corporate code of conduct.
   C. Accept responsibility for restated earnings.
   D. All of the above.

113. An audit committee must be comprised of outside directors and at least one outside financial expert. An individual with which of the following characteristics is considered an outside director?

   A. A director who is not a member of management and has no other relationship to the organization.
   B. A consultant to the organization 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 organization.

114. Audit committees are <u>required</u> to include which of the following types of professionals?

A. A CPA.
B. A public regulator.
C. A financial expert.
D. An attorney-at-law.

115. **Fraud motivations and factors**

Research consistently shows that there are three factors associated with most frauds. List these factors and at least three indicators that the factor may exist for a particular company.

116. **Consideration of fraud in an audit**

Auditors are required to actively conduct a financial statement audit with the mindset that fraud may exist. What is the general process that an auditor goes through to assess the risk of fraud and test accordingly?

117. **Fraud consideration by auditors**

John Beasley is interviewing with public audit firms to become an auditor. John does not believe that fraud is a "big deal" in client organizations and argues that most individuals in management of companies are "honest people". He believes that auditors are becoming too cynical.

Describe your response to John's attitude and discuss the major types of fraud that occur in companies.

118. **PCAOB Independence Standards**

What are four requirements of the Sarbanes-Oxley that seek to protect auditor independence?

119. **Enron: A Fraud Example**

What were the failures that allowed the Enron fraud to occur?

120. **Fraud categories**

What are three common ways in which fraudulent financial reporting takes place?

121. **Audit Committee Responsibilities**

Describe the responsibilities of audit committees, and list at least four responsibilities that the NYSE has mandated for audit committees.

122. **Auditor's response to fraud risk factors**

The auditor assesses the identified fraud risks after taking into account an evaluation of the client's programs and controls. How might the auditor respond to the results of the assessment of higher fraud risk?

123. **Auditor's fraud communication responsibilities**

Discuss the auditor's responsibility to communicate fraud to the audit committee. When is the auditor required to communicate possible fraud to parties other than the audit committee and management?

124. **Linking internal deficiencies to audit procedures**

After assessing internal control weakness the auditor develops audit procedures to explicitly test for the existence of the types of fraud or misstatement that could occur because of the weakness. In the linkage process from control deficiencies to audit procedures, what are the four questions involved in linking changes to the audit program?

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30. One fraud risk factor includes the presence of domineering members of management who seek the ultimate loyalty of subordinates.

TRUE

31. The audit team should develop its own ideas about how fraud may be performed by the client and then covered up.

TRUE

32. Audit tests do not relate to fraud testing because testing for fraud is conducted in a separate engagement.

FALSE

33. When the risk of fraud is high in financial statements, the auditor should assign less experienced auditors to the engagement.

FALSE

34. Various types of ways that fraud could be perpetrated should be hypothesized by the auditor prior to conducting audit testing.

TRUE

35. When fraud risk is great in the organization under audit, procedures applied are likely to be more extensive.

TRUE

36. Material fraud perpetrated by management must always be reported by the auditor to the SEC.

FALSE

37. During the time period of 1998 to 2007, the median size of public company perpetrating fraud rose tenfold to $100 million (as compared to the previous ten years).

TRUE

38. According to COSO studies, the majority of the frauds took place at companies that were listed on the Over-The-Counter (OTC) market, rather than those listed on the NYSE or NASDAQ.

TRUE

39. Auditors are responsible to fraud even if it has an immaterial effect on the financial statements.

FALSE

40. The landmark Enron fraud in the early 2000's involved the movement of significant debt off the books to related, unconsolidated entities.

TRUE

41. Successful corporate governance depends upon successful management of the company, as management has the primary responsibility for creating a culture of performance with integrity and ethical behavior.

TRUE

42. Transparency is a desirable, but not critical, element of effective corporate governance.

FALSE

43. The auditor has a responsibility to design the audit to provide absolute assurance of detecting material fraud.

FALSE

44. When preliminary fraud risk is high the auditor should pay close attention to areas of the audit that are highly subjective and should increase the predictability of the audit procedures.

FALSE

45. The auditor can be satisfied with less than persuasive evidence in the audit process because of the belief that management is honest.

FALSE

46. Professional skepticism involves such things as questioning and corroborating management responses to inquiries and determining the authenticity of documents.

TRUE

47. The objective of financial reporting is to provide useful information to interested users.

TRUE

48. Corporate governance is a process by which the owners, but not the creditors, exert control and require accountability for the resources entrusted to the organization.

FALSE

49. The audit committee is a subcommittee of the board of directors comprised of independent outside directors.

TRUE

50. The auditor must communicate significant audit adjustments to the audit committee.

TRUE

51. Any major disagreement the auditor has with management should be discussed with the audit committee.

TRUE

52. Managers of organizations are hired by Boards of Directors to perform responsibilities such as the implementation of internal control.

TRUE

53. An audit must be performed by persons who can make sound judgments relating to complex accounting issues.

TRUE

54. The audit committee must be composed of outsiders such as the organization's attorney and audit partner.

FALSE

55. Management of companies should have the ability to hire and fire the external auditor.

FALSE

56. The audit committee should have the authority to hire and fire the external auditor.

TRUE

57. Auditors are required to inform the audit committee of any significant audit adjustments discovered during the engagement.

TRUE

58. Audit committees of publicly traded companies must establish whistleblowing mechanisms within the company.

TRUE

59. Why is fraud detection an important part of the audit?

A. Auditors are required to seek out and find all fraud, regardless of its magnitude.
B. Auditors expect that management will make them aware of any fraud in the financial statements.
C. Society expects that financial statements have not been materially misstated due to fraud.
D. Society realizes that some fraud was not intended to be discovered by auditors.

60. Which of the following statements about fraud is true?

A. Unless auditors can provide assurance that the financial statements are free of material misstatements due to fraud, there is no justification for the audit function.
B. The AICPA has mandated that the auditor take on more responsibility than previously required because of management's demand for fraud detection.
C. It is the responsibility of the auditor to provide internal control over a client organization sufficient to discover or prevent fraud from occurring.
D. Auditor-initiated fraud is a large concern of shareholders and the audit committee must continually monitor the auditors to ensure they are not misstating financial statements.

61. Which of the following represents the size of company that has historically committed fraudulent financial reporting or that has experienced asset misappropriation by its employees?

A. Large corporations.
B. Middle-market corporations.
C. Small and start-up companies.
D. All companies.

62. What is the primary determinate in the difference between fraud and errors in financial statement reporting?

A. The materiality of the misstatement.
B. The intent to deceive.
C. The level of management involved.
D. The type of transaction affected.

63. Which of the following statements reflects an auditor's responsibility for detecting fraud?

A. An auditor is not responsible for discovering fraudulent acts involving employee collusion.
B. The audit should be planned to detect fraud caused by departures from GAAP.
C. An auditor is only responsible for detecting fraudulent financial reporting.
D. An auditor should design the audit to provide reasonable assurance of detecting errors and fraud that are material to the financial statements.

64. Which of the following best represents fraudulent financial reporting?

A. The transfer agent issues 40,000 shares of the company's stock to a friend without authorization by the board of directors.
B. The controller of the company decreases warranty expense by $3 million because the company will otherwise miss analysts' expectations this quarter.
C. The in-house attorney receives payments from the French government for negotiating the development of a new plant in Paris.
D. The accounts receivable clerk covers up the theft of cash receipts by writing off older receivables without authorization.

65. According to professional auditing standards, which of the following **best** represents a type of fraudulent financial reporting?

A. Management accrues a liability and discloses the possible outcome of a lawsuit prior to settling the matter.
B. Management reclassifies a negative cash balance by increasing cash and also increasing a current liability.
C. Management discloses its failure to meet loan covenants but states that a waiver has been received.
D. Management intentionally excludes a subsidiary from its consolidated results that it controls significantly.

66. What type of fraud occurs when the deposits of current investors are used to pay returns on the deposits of previous investors with no real investment happening?

A. Skimming.
B. Ponzi Scheme
C. Channel Stuffing.
D. Payroll Fraud.

67. Which of the following is most likely considered an omission from financial statement reporting?

A. The company no longer discloses a contingency because it was settled previously.
B. The company does not present goodwill because it was impaired currently.
C. The company does not disclose earnings per share because it is privately held.
D. The company does not present a statement of cash flows because of its current net loss.

68. Which of the following is the most common type of fraudulent financial reporting?

A. Capitalizing major overhauls to operating equipment.
B. Deferring service revenue until it is delivered to customers.
C. Including as sales inventory sold with the right to return.
D. Excluding a contingent liability that has been settled.

69. Which of the following best represents an example of fraud utilizing the lapping technique?

A. An employee transfers cash on the last day of the year in order to double record it in the bank accounts.
B. An employee creates a fictional vendor and requests payment to a personal P.O. box.
C. An employee opens the mail to cover up payroll fraud received on a fictional person.
D. An employee covers up the stealing of receipts by posting to the wrong customer accounts.

70. Which is not an example of the theft of accounts receivable?

A. Recording discounts to customers, stealing the cash, and then reducing accounts receivable for the amount of cash stolen.
B. Creating fictional invoices and customers and recording accounts receivable.
C. Writing off accounts receivable as uncollectible to hide receipts taken.
D. Posting upcoming payments to the account of a customer whose most recent payment was diverted.

71. Who is most often involved in perpetrating fraudulent financial reporting?

A. The auditors and the attorneys.
B. The treasurer and the board of directors.
C. The chief executive and chief financial officers.
D. The shareholders and the chief operating officer.

72. What is the best way an auditor can detect fraud in the financial statements?

A. Use professional skepticism.
B. Understand Generally Accepted Accounting Standards.
C. Brainstorm with the client to find the types of fraud occurring.
D. Actively search for errors in the financial statements.

73. How must an auditor address fraud in the planning stage?

A. The auditor must test for fraud in the planning stage by sampling accounts.
B. The auditor must consider the likelihood of fraud existing in the company in the planning stage.
C. The auditor must realize that most people are honest and not automatically assume that fraud exists when planning the audit.
D. The auditor must not be aggressive in its initial approach to fraud as trust may be lost by the client.

74. What should an audit team do when it discovers that fraud risk factors are present on an audit engagement?

A. Retract from the client and inform regulatory bodies.
B. Modify procedures to actively search for the existence of fraud.
C. Reduce the amount of evidence required and resort to management inquiry.
D. Turn the audit over to forensic accountants.

75. The fraud triangle says three conditions are generally present in the client's organization when fraud occurs. Which of the following is not one of those conditions?

A. Incentives.
B. Professional Skepticism.
C. Opportunity.
D. Ability to rationalize fraud.

76. Which of the following best represents actions that may indicate fraud is pervasive throughout the company under audit?

A. The company's management negotiates deals with vendors in such a manner as to pay lower prices.
B. The company's management drives luxury vehicles and takes vacations to exotic places.
C. The company's management takes an overly aggressive approach to revenue recognition.
D. The company's management estimates bad debts using an aged accounts receivables ledger rather than as a percent of sales.

77. Which of the following best describes professional skepticism?

A. An intent to deceive.
B. An attitude of intrusion and obstinacy.
C. A character that does not waver.
D. A questioning mind.

78. According to professional audit standards, how might an understanding of the nature of fraud that may occur in the client organization be identified by an audit firm?

A. Fraud training courses from actual corporate fraud ex-criminals.
B. Conducting a brainstorming session with the members of the audit team.
C. Circulating a survey to the client company employees for completion.
D. Discussions with other audit firms.

79. Which of the following situations represents a risk factor that relates to misstatements arising from misappropriation of assets?

A. A high turnover of senior management.
B. A lack of independent checks.
C. A strained relationship between management and the predecessor auditor.
D. An inability to generate cash flow from operations.

80. The Center for Audit Quality (CAQ) report identifies which of the following ways in which individuals involved in the financial reporting process can mitigate the risk of fraudulent financial reporting?

A. Individuals involved in financial reporting need to acknowledge that there needs to exist a strong, highly ethical tone at the top of an organization that permeates the corporate culture, including an effective fraud risk management program.
B. Individuals involved in financial reporting need to continually exercise professional skepticism.
C. Individuals involved in financial reporting need to remember that strong communication among those involved in the financial reporting process is critical.
D. All of the above.

81. Which of the following frauds is most common?

A. Chief financial officer misappropriation of funds.
B. Misapplication of revenue recognition principles.
C. Management's theft of cash held in reserve accounts.
D. Over-recording expenses related to stock options.

82. Which of the following is an example of fraud?

A. A mistake in processing accounting data.
B. An incorrect accounting estimate arising from misinterpretation of facts.
C. Misappropriation of an asset.
D. A mistake in the application of accounting principles.

83. How will the results of the auditor's assessment of fraud risk factors affect the planned audit procedures?

A. Audit procedures and fraud assessment do not relate.
B. The assessment may require a re-audit of previous periods.
C. Qualified audit staff will be assigned to relevant areas of the engagement.
D. Management will be called upon to assist in coordinating audit procedures.

84. When is the assessment of fraud risk complete?

A. Upon completion of the planning stage.
B. Once internal control is understood.
C. Only after the audit risk model has been used to design tests.
D. Once the audit is complete.

85. Protection Transparency, Inc. is being audited by Messer and Bromely, LLP. During the assessment of fraud, Messer and Bromely discover that the controller has been creating fictional sales and posting them to the general ledger. Who should the auditors make aware of this issue?

A. Protection Transparency's legal counsel.
B. The police.
C. The chairman of Protection Transparency's audit committee.
D. The predecessor auditor of Protection Transparency.

86. Management of Premium Discovery Company is compensated through large salaries, stock options and bonuses tied to the company's working capital growth. The CEO is constantly holding meetings to ensure that management is on target for increased operating income each month. Based upon the above information only, what type of probable motivation is there to commit fraud at the Premium Discovery Company?

A. Incentive.
B. Opportunity.
C. Rationalization.
D. Expectation.

87. Which of the following creates an opportunity for fraud to be committed in an organization?

A. Management demands financial success.
B. Poor internal control.
C. Commitments tied to debt covenants.
D. Management is aggressive in its application of accounting rules.

88. Which of the following statements about the Bernie Madoff ponzi scheme is false?

A. Madoff too advantage of his unique ties to the investment community (he was the former Chair of the NASDAQ) to create trust and encourage further investments.
B. Madoff began perpetrating the fraud shortly before passage of the Sarbanes-Oxley Act, and the provisions of that Act ultimately led to discovery of the fraud.
C. Madoff was sentenced to 150 years in prison.
D. The estimated amount missing from client accounts, including fabricated gains, was almost $65 billion.

89. Sam Jones, controller of Mitnikco, spends three days researching the accounting statements to find loopholes in the "rules" and to make a case for recognizing revenue earlier, rather than in later years. In the end, Sam and the other members of management determine that they will reduce the company's deferred revenue accounts and begin accounting for all revenues as agreements are signed. What are the motivations of Mitnikco management based solely on the information above?

A. Pressures.
B. Opportunity.
C. Rationalization.
D. Skepticism.

90. There are many important reasons to diligently plan for an audit. If an audit firm wrongly skips the planning stage of an audit, what will be effect relative to fraud detection?

A. The firm will not be able to apply GAAP to the financial statements.
B. The firm will not adequately identify the types of fraud that may occur in the client company.
C. The firm will not be able to perform direct tests of account balances.
D. The firm will lack the competency and technical training necessary to complete the audit in accordance with GAAS.

91. Which of the following statements about fraud or fraud detection is true?

A. Management may physically alter evidence to perpetrate and conceal the fraud.
B. Most fraudulent financial reporting is not material enough to consider.
C. Journal entries do not supply evidence necessary to detect fraud.
D. The advent of new technology prevents fraud, thereby leading to less fraud over time.

92. How did the Sarbanes-Oxley Act strengthen auditor independence?

A. By requiring auditors to provide reports in accordance with the Foreign Corrupt Practices Act.
B. By requiring auditors to report the nature of any auditor-client disagreements to the SEC.
C. By requiring audit committees to appoint the auditors.
D. By requiring a different audit firm from the one that performs the audit to prepare the client's tax return.

93. Which of the following frauds involved primarily asset misappropriation?

A. Enron.
B. Worldcom.
C. Dell.
D. Koss.

94. Which of the following factors should an auditor consider in evaluating the effect of fraud upon the planned audit procedures?

A. The type of fraud that may occur.
B. The potential materiality of fraud.
C. The likelihood of fraud occurring.
D. All of the above.

95. The audit team asks management for original documents related to sales contracts. Despite the team's persistence, management does not supply the documents for over two weeks. What should this audit team be most concerned with as it relates to these documents?

A. The need to complete the audit within a specified period of time.
B. Management's possible use of the time to fabricate the documents.
C. Discrepancies of the evidence.
D. Conflicting evidence.

96. Who should the auditors first notify if they discover a material fraud?

A. The PCAOB.
B. The SEC.
C. The management of the company.
D. The audit committee of the company.

97. Who should the auditors first notify if they discover a material misappropriation of assets?

A. The PCAOB.
B. The SEC.
C. The management of the company.
<u>D.</u> The audit committee of the company.
E. They are not required to notify anyone.

98. Which of the following statements best describes the outcome of the auditor discovering fraud in the financial statements?

<u>A.</u> The outcome will depend on the type of the fraud, along with its materiality.
B. Management must disclose any and all fraud directly in the footnotes.
C. The auditor is required to include a full description of the fraud in the audit report to the financial statements.
D. There is no bearing on the financial statements by fraud that is discovered by the auditor.

99. If management makes appropriate adjustments to correct the implications of a fraud discovered in a financial statement audit, but does not take appropriate steps to modify internal controls, upon what does this have a direct impact?

A. The auditor's opinion on the financial statements.
B. The client's executive compensation.
<u>C.</u> The auditor's perception of the overall control environment.
D. All previous work performed by the auditor on this client.

100. In considering corporate governance responsibilities and accountabilities, which of the following are considered stakeholders to whom the board of directors, management, and internal auditors are accountable?

A. Shareholders/owners.
B. External auditors.
C. Regulators.
D. Both A and C.
<u>E.</u> All of the above.

101. Which of the following represents fraud procedures used by auditors?

A. The auditor must disregard complex transactions for reasons of economic substance.
<u>B.</u> The auditor cannot allow the client to pressure the timing of the audit for early release of earnings.
C. The auditor must put less emphasis on capital additions and more on payroll.
D. The auditors must no longer use confirmations and move forward to internal verification.

102. Which of the following items are registered audit firms <u>not</u> required to report to the audit committee?

A. Critical accounting policies and practices.
B. Alternative treatments of financial information within generally accepted accounting principles that have been considered by management, as well as the preferred treatment of the audit firm.
<u>C.</u> A list of all audit procedures performed.
D. Significant written communications between the audit firm and management.

103. Which of the following is <u>not</u> one of the components of the fraud risk model?

A. Incentive.
B. Rationalization.
C. Susceptibility.
<u>D.</u> Auditors do not use a fraud risk model.

104. A common accounts receivable fraud is lapping. Which of the following is a more sophisticated accounts receivable fraud?

A. Using journal entries to write off accounts against the allowance for doubtful accounts.
B. Applying cash from one customer's receivable to that of another to cover the earlier deficit.
C. Recording large discounts for the clients.
<u>D.</u> Both A and C.

105. The fraud triangle has three components. Which of the components must be present for a fraud to occur?

<u>A.</u> All factors must be present for fraud to occur.
B. All factors need not be present.
C. Fraud can occur if any one of the factors is present.
D. None of the above

106. Which of the following best describes how corporate governance influences an organization?

A. To exert control over management.
B. To hold management accountable for its actions.
<u>C.</u> To exert control over management and hold management accountable for its actions.
D. To neither exert control over management or hold management accountable for its actions.

107. Who is responsible for operating an enterprise?

A. The auditor.
B. The audit committee.
<u>C.</u> Management.
D. The board of directors.

108. Who is the client in an audit engagement?

A. Management.
B. The SEC.
<u>C.</u> The audit committee.
D. The stockholders.

109. Which of following best describes the audit committee's oversight responsibility?

A. Provide oversight of reporting outside the organization.
B. Provide oversight of internal auditing function.
C. Provide oversight of the external audit.
<u>D.</u> All of the above.

110. Which of the following facts should be communicated by the auditor to the audit committee?

A. The auditor's responsibilities under GAAP.
B. All significant audit adjustments.
C. Significant accounting policies.
<u>D.</u> All are required communications.

111. Which of the following is not one of management's responsibilities?

A. Ensuring accounting principles are following in preparing financial statements.
<u>B.</u> Engaging a qualified auditor.
C. Implementing effective internal controls.
D. Ensuring financial statements and disclosures are accurate.

112. Which of the following best describes management responsibilities under the Sarbanes-Oxley Act of 2002?

A. Certify the accuracy of financial statements.
B. Establish a corporate code of conduct.
C. Accept responsibility for restated earnings.
<u>D.</u> All of the above.

113. An audit committee must be comprised of outside directors and at least one outside financial expert. An individual with which of the following characteristics is considered an outside director?

<u>A.</u> A director who is not a member of management and has no other relationship to the organization.
B. A consultant to the organization 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 organization.

114. Audit committees are <u>required</u> to include which of the following types of professionals?

A. A CPA.
B. A public regulator.
<u>C.</u> A financial expert.
D. An attorney-at-law.

115. **Fraud motivations and factors**

Research consistently shows that there are three factors associated with most frauds. List these factors and at least three indicators that the factor may exist for a particular company.

<u>Factor</u>	**<u>Indicators</u>**
Incentives or Pressures	-Management compensation schemes. -Financial pressure to improve trends. -Personal need for financial enhancement. -Compliance with debt covenants.
Opportunities	-Significant related-party transactions. -Industry dominance. -Influence over suppliers or customers. -Volume of subjective judgments by management. regarding valuation and other estimates. -Simple transactions made complex. -Complex or difficult to understand transactions (including SPEs/VIEs and derivatives). -Ineffective monitoring by management. -Complex or unstable organizational structure. -Weak or nonexistent internal controls.
Attitudes or Rationalization	-Pushing accounting limits. -Aggressive accounting stance. -Audit firm answers to management and not the audit committee. -Audit firm focus is on consulting for higher fees rather than audit services. -Stock analyst misguidance. -"The company owes me!"

116. **Consideration of fraud in an audit**

Auditors are required to actively conduct a financial statement audit with the mindset that fraud may exist. What is the general process that an auditor goes through to assess the risk of fraud and test accordingly?

1. Understand the nature of fraud, the motivations to commit fraud, and the manner in which fraud may be perpetrated.
2. Exercise "professional skepticism" throughout the entire fraud risk assessment process.
3. "Brainstorm" and share knowledge with other audit team members.
4. Obtain information useful in identifying and assessing fraud risk.
5. Identify the specific fraud risks, including potential magnitude, and areas likely to be affected by a fraud.
6. Evaluate the quality of the company's controls and potential effectiveness in mitigating the risk of fraud.
7. Respond, i.e. adjust audit procedures to assure that the audit adequately addresses the risk of fraud and provides evidence specifically related to the possibility of fraud.
8. Evaluate findings. If evidence signals that a fraud might exist, determine whether or not forensic or specialist auditors are needed to complete the investigation.
9. Communicate the possibility that fraud exists to management, or to the audit committee or the full board if the fraud is material and/or involves members of management.
10. Document the audit approach starting with the step 1 through the completion of all of the steps identified above.

117. **Fraud consideration by auditors**

John Beasley is interviewing with public audit firms to become an auditor. John does not believe that fraud is a "big deal" in client organizations and argues that most individuals in management of companies are "honest people". He believes that auditors are becoming too cynical.

Describe your response to John's attitude and discuss the major types of fraud that occur in companies.

Audit firms have taken criticism for failing to discover material frauds. Auditors have a greater responsibility to plan the audit to consider and detect fraud. This is accomplished partially by the auditor's use of professional skepticism. Professional skepticism is not necessarily being cynical; rather, it is performing an audit with a questioning mind. It means that the auditors will obtain persuasive evidence to corroborate management responses to inquiries and to increase the sufficiency of substantive audit evidence. Professional skepticism is exhibited in the auditor's assumption that honesty in people is not a given. Auditors must not only go beyond the evidence in front of them, they must have the mindset of the possibility of fraud in all financial statement engagements.

It must also be mentioned that John's perspective will likely not be acceptable to the audit firm because his attitude toward fraud is not rigorous enough for the profession.

John must realize that, quite often, fraud in organizations usually takes place in one of three areas:

Asset misappropriation such as theft and misuse of assets.

Fraudulent financial reporting such as the overstatement of certain assets and revenues and the understatement of certain liabilities and expenses.

118. **PCAOB Independence Standards**

What are four requirements of the Sarbanes-Oxley that seek to protect auditor independence?

Sarbanes-Oxley: Auditor Independence

201 Services outside the scope of practice of auditors. There exist a variety of services that registered audit firms may not perform for issuers, such as bookkeeping, systems design, appraisal services,
and internal auditing, among others. Tax services may be performed, but only with pre-approval by the audit committee.

202 Preapproval requirements. All audit and non-audit services (with certain exceptions based on size and practicality) must be approved by the audit committee of the issuer.

203 Audit partner rotation. The lead partner and reviewing partner must rotate off the issuer engagement at least every five years.

204 Auditor reports to audit committees. Registered audit firms must report to the audit committee issues concerning:

- Critical accounting policies and practices
- Alternative treatments of financial information within generally accepted accounting principles that have been considered by management, as well as the preferred treatment of the audit firm
- Significant written communications between the audit firm and management

206 Conflicts of interest. Registered audit firms may not perform audits for an issuer whose CEO, CFO, controller, chief accounting officer, or other equivalent position was employed by the audit firm during the one –year period preceding the audit. This is known as a "cooling off period."

119. **Enron: A Fraud Example**

What were the failures that allowed the Enron fraud to occur?

Weak Management Accountability. Management was virtually not accountable to anyone as long as the company showed dramatic stock increases justified by earnings growth.

Incompetent Corporate Governance. Although the board appeared to be independent, most of the board members had close ties to management of the company through philanthropic organizations.

Accounting Rules. Accounting became more rule-oriented and complex. Accounting allowed practitioners to take obscure pronouncements, such as those dealing with Special Purpose Entities that were designed for leasing transactions, and apply the pronouncement to other entities for which such accounting was never intended.

Enthusiastic Financial Analyst Community. Financial analysts that were riding the bubble of the dot-com economy concluded they did not have tools to appropriately value many of the emerging companies.

Biased Banking and Investment Banking. Many large financial institutions were willing participants in the process because they were rewarded with large underwriting fees for other Enron work.

Lack of an Independent External Auditor. At the time of Enron, the largest five external auditing firms referred to themselves as professional service firms with diverse lines of business. All of the firms had large consulting practices. Arthur Andersen performed internal audit work for Enron, in addition to performing the external audit. The consulting fees of many clients dramatically exceeded the audit fees. Partners were compensated on revenue and profitability. Worse yet, auditors were hired by management who sometimes succeeded in pressuring auditors to acquiesce to aggressive financial reporting preferences.

120. **Fraud categories**

What are three common ways in which fraudulent financial reporting takes place?

1. Manipulation, falsification, or alteration of accounting records or supporting documents.
2. Misrepresentation or omission of events, transactions, or other significant information
3. Intentional misapplication of accounting principles

121. **Audit Committee Responsibilities**

Describe the responsibilities of audit committees, and list at least four responsibilities that the NYSE has mandated for audit committees.

Section 301 of the Sarbanes-Oxley Act outlines the responsibilities of audit committee members for publicly traded companies, stating that audit committees are to be directly responsible for the appointment, compensation, and oversight of the work of registered accounting firms; they must be independent; they must establish "whistleblowing" mechanisms within the company; they must have the authority to engage their own independent counsel; and companies must provide adequate funding for audit committees.

In addition to these broad responsibilities, the NYSE has mandated certain specific responsibilities of audit committees, including:

- Obtaining each year a report by the external auditor that addresses the company's internal control procedures, any quality control or regulatory problems, and any relationships that might threaten the independence of the external auditor
- Discussing the company's financial statements with management and the external auditor
- Discussing in its meetings the company's earnings press releases, as well as financial information and earnings guidance provided to analysts
- Discussing in its meetings policies with respect to risk assessment and risk management
- Meeting separately with management, internal auditors, and the external auditor on a periodic basis
- Reviewing with the external auditor any audit problems or difficulties that they have had with management
- Setting clear hiring policies for employees or former employees of the external auditors
- Reporting regularly to the board of directors

In addition to these responsibilities, in many companies the audit committee also has the authority to hire and fire the head of the internal audit function, set the budget for the internal audit activity, review the internal audit plan, and discuss all significant internal audit results. Other responsibilities might include performing or supervising special investigations, reviewing policies on sensitive payments, and coordinating periodic reviews of compliance with company policies such as corporate governance policies.

122. **Auditor's response to fraud risk factors**

The auditor assesses the identified fraud risks after taking into account an evaluation of the client's programs and controls. How might the auditor respond to the results of the assessment of higher fraud risk?

The auditor should consider:

-Professional skepticism
  a) Obtain more reliable evidence
  b) Obtain additional corroborating evidence.
-Assignment of personnel and supervision--specialists or more experienced personnel
-More careful consideration of management's selection and application of accounting principles
-Adding an element of unpredictability to auditing procedures

The auditor may change the nature, timing and extent of the audit procedures to be performed by increasing the extent of procedures, making them more persuasive, and moving more of them to the balance sheet date or later.

The response may involve the performance of procedures to further consider the risk related to:
a) Revenue recognition
b) Inventory quantities
c) Management estimates

Responses to consider the risk of management override of controls may include:
a) Examine journal entries and other adjustments made in preparation of financial statements
b) Review accounting estimates for biases
c) Evaluate business rationale for significant unusual transactions

123. **Auditor's fraud communication responsibilities**

Discuss the auditor's responsibility to communicate fraud to the audit committee. When is the auditor required to communicate possible fraud to parties other than the audit committee and management?

If the fraud is material (as previously agreed to with the audit committee) or if it involves senior management then it should be reported directly to the audit committee. Also if it has continuing control implications, the auditor should consider whether it is a "significant control deficiency" that should be reported to the audit committee.

The auditor normally is limited in their ability to disclose fraud to outside parties because of the confidentiality requirement. However, communication of fraud to parties other than the client may be required:

a) To comply with legal and regulatory requirements
b) To a successor auditor
c) In response to a subpoena
d) To a funding agency involving governmental financial assistance

124. **Linking internal deficiencies to audit procedures**

After assessing internal control weakness the auditor develops audit procedures to explicitly test for the existence of the types of fraud or misstatement that could occur because of the weakness. In the linkage process from control deficiencies to audit procedures, what are the four questions involved in linking changes to the audit program?

The auditor has to consider what could go wrong and then decide on the audit evidence that is needed to determine if fraud has occurred. The linkage process from control deficiencies to audit procedures involves the following thought process to identify potential changes to the audit program:

-What types of misstatements could occur because of the control deficiencies?
-What account balances would be affected and how would they be affected?
-What audit procedures would provide evidence on whether the account balance contains misstatements?
Do the planned audit procedures emphasize objective evidence that is outside the responsibility of the parties that have access to the assets?