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'During the course of our audit we discovered that the company had incorrectly reclaimed input value added tax totalling \$42,000. We have notified the client in writing of the need to repay this amount to tax authority as soon as possible. The financial statements have been adjusted to include this sum within current liabilities as 'amounts payable to Tax Authority'.

Included within income in the company's management accounts for the ten months ended 28 February 2013 is a credit entry for \$42,000 described as 'VAT difference written off'.

Which one of the following actions is LEAST likely to be taken in respect of this matter?

- A. Report to nominated officer/money laundering officer within the firm
- B. Report to board of directors
- C. Avoid tipping off the client
- D. Consider resignation

Correct Answer: B

QUESTION 30

An auditor performs an analytical review by comparing the gross margins of various divisional operations with those of other divisions and with the individual division's performance in previous years. The auditor notes a significant increase in the gross margin at one division. The auditor does the preliminary investigation and notes that there were no changes in products, production methods, or divisional management during the year. Based on the above information, the most likely cause of the increase in gross margin would be:

- A. An increase in the number of competitors selling similar products.
- B. A decrease in the number of suppliers of the material used in manufacturing the product.
- C. An overstatement of year-end inventory.
- D. An understatement of year-end accounts receivable.

Correct Answer: C

QUESTION 31

There is a risk that management may be biased in the judgements when calculating estimated figures. The auditor must therefore approach these values with professional scepticism regarding the judgements.

The audit approach required is set out in ISA 540 Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures. Essentially, if risk assessment procedures have identified a risk of material misstatement due to accounting estimates, the auditor can respond by undertaking different methods.

To test the process that management used to calculate the provision for doubtful accounts receivable, the auditor may use all of the following methods except:

- A. Looking at past experience
- B. Comparing with the provision made by industry average
- C. Checking the calculation
- D. Considering if anything is likely to have changed the estimate this year

Correct Answer: B

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QUESTION 32

Assurance providers obtain evidence using procedures set out in ISA 500.

Identify which type of audit procedures is / are correctly paired with each tests carried out by an auditor.

Tests Audit procedures

(i) The assurance provider writes to a sample of customers asking them to inform him of the balance they owe the inspection company at the year end

(ii) The assurance provider looks at a share certificate to confirm that the company has an investment in Company A Observation

(iii) The assurance provider attends the inventory count and ensures that it is being carried out in accordance with Confirmation the issued instructions

- A. (i) and (ii) only
- B. (ii) and (iii) only
- C. All are correct
- D. All are incorrect

Correct Answer: D

QUESTION 33

A personnel department is responsible for processing placement agency fees for new hires. A recruiter established some bogus placement agencies and, when interviewing walk-in applicants, the recruiter would list one of the bogus agencies as referring the candidate. A possible means of detection or deterrence is to:

- A. Process all personnel agency invoices via a purchase order through the purchasing department.
- B. Verify new vendors to firms listed in a professional association catalog and/or verify the vendor name and address through the telephone book.
- C. Monitor the closeness of the relationships of recruiters with specific vendors.
- D. Require all employees to sign an annual conflict of interest statement.

Correct Answer: B

QUESTION 34

After partially completing an internal control review of the accounts payable department, the auditor suspects that some type of fraud has occurred. To ascertain whether the fraud is present, the best sampling approach would be to use:

- A. Simple random sampling to select a sample of vouchers processed by the department during the past year.
- B. Probability-proportional-to-size sampling to select a sample of vouchers processed by the department during the past year.
- C. Discovery sampling to select a sample of vouchers processed by the department during the past year.
- D. Judgmental sampling to select a sample of vouchers processed by clerks identified by the

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department manager as acting suspiciously.

Correct Answer: C

QUESTION 35

Frederich Gastona has been invited by ECA Co to perform the audit of financial statements of 2012-13. When deciding whether to accept an auditing engagement, Frederich must judge his independence and objectivity. If Frederich's audit firm lacks independence or objectivity, Frederich can't accept the engagement. What does "Independence" mean in the context of the above case?

- A. Remaining aloof from client ECA Co.
- B. Not being financially dependent on client ECA Co.
- C. Taking an unbiased viewpoint while conducting audit of ECA Co.
- D. Being an advocate for ECA Co in the law suit.

Correct Answer: C

QUESTION 36

An employee of an insurance company processed a fraudulent policy loan application for an amount less than the established level requiring supervisory review. The employee then obtained the cheque and cashed it by forging the endorsement. To prevent the loan's appearance on a subsequent policyholder statement, the loan amount was transferred to a "suspense" account. Which of the following should expose this situation at the earliest date?

- A. A computer report identifying unusual entries to the suspense account.
- B. The use of pre-numbered checks which are periodically accounted for.
- C. An annual internal audit.
- D. Regular reconciliation of the "suspense" account performed by an independent employee.

Correct Answer: A

QUESTION 37

Your firm has recently been appointed as auditor to Crate Ltd for the year ending 31 October 2012. This is the first year of audit for Crate Ltd as it fell below the statutory audit exemption limits for the year ended 31 October 2011, which was the company's first period of trading. Which of the following is NOT a matter to be considered in respect of the opening balances of Crate Ltd?

- A. Check opening balances correctly brought forward
- B. Check appropriateness of accounting policies or their consistent application from year to year
- C. Assess whether financial statements need amendment
- D. Ensure disclosure of lack of audit in prior year in financial statements

Correct Answer: C

QUESTION 38

Deteriora Ltd has recently started up the audit of a new client, Thatch plc. The auditor has identified that Thatch plc has few employees in its accounting department. Which of the following is the MOST appropriate approach that should be used by Deteriora Ltd under this circumstance?

- A. Tests of control only

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- B. Substantive procedures only
- C. A mix of tests of control and substantive procedures
- D. No test is required

Correct Answer: B

QUESTION 39

Auditing standards require that the auditor and the client agree on the terms of the engagement. The agreed terms must be in writing and the usual form would be a letter of engagement. Any other form of appropriate contract, however, may be used. Which of the following is NOT a benefit of an engagement letter in respect of assurance services?

- A. Clearly defines the extent of the assurance provider's responsibilities
- B. Provides written confirmation of the acceptance of the engagement
- C. Confirms the scope of the engagement
- D. Certifies the assurance provider's opinion

Correct Answer: D

QUESTION 40

Accounting principle assumes that, a company will continue to exist long enough to carry out its objectives and commitments and will not liquidate in the foreseeable future. Which of the following audit procedures is most likely to assist an auditor in identifying conditions and events that may indicate substantial doubt about an entity's ability to continue as a going concern?

- A. Confirmation of accounts receivable from principal customers.
- B. Reconciliation of interest expense with debt outstanding.
- C. Confirmation of bank balances.
- D. Review of compliance with terms of debt agreements.

Correct Answer: D

QUESTION 41

After completing an internal control review of the accounts payable department partially, the auditor suspects that some type of fraud has occurred. To ascertain whether the fraud is present, the best sampling approach would be to use:

- A. Simple random sampling to select a sample of vouchers processed by the department during the past year.
- B. Monetary unit sampling to select a sample of vouchers processed by the department during the past year.
- C. Discovery sampling to select a sample of vouchers processed by the department during the past year.
- D. Judgmental sampling to select a sample of vouchers processed by clerks identified by the department manager as acting suspiciously.

Correct Answer: C

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QUESTION 42

Norman & Co is the external auditor of Diamond plc, a listed company. The directors of Diamond plc have requested that Norman & Co carry out a review engagement assessing the effectiveness of its corporate governance policies against the UK Corporate Governance Code. Which of the following understanding is LEAST necessary for Norman & Co to understand Diamond plc and its environment?

- A. Relevant industry, regulatory, and other external factors related with Diamond plc
- B. The nature of Diamond plc, including its operations, ownership, governance structures and the types of investments
- C. Diamond plc's marketing plan for next one year
- D. Diamond plc's selection and application of accounting policies

Correct Answer: C

QUESTION 43

Rehan & Co has been appointed as an external auditor of Limba Plc for the financial year 2011-12. Rehan & Co has identified some problems in the financial statements and now at the final stage of writing the report on the audit. In which of the following case, Rehan & Co may issue an adverse opinion?

- A. Some parts of the financial statements of Limba Plc are materially misstated or misleading.
- B. Some parts of the financial statements of Limba Plc found misleading or misstated on the performed investigation but Rehan & Co is not sure about their pervasiveness.
- C. The overall financial statements of Limba Plc are as materially misstated or misleading as a whole that they do not present fairly the financial position or results of operations and cash flows in conformity with IFRS.
- D. The audit firm, Rehan & Co, is not independent from the management of Limba Plc.

Correct Answer: C

QUESTION 44

Internal auditors must exercise due care if they are to meet their responsibilities for fraud detection. Thus, the existence of certain conditions should raise auditor's professional scepticism concerning possible fraud. Which of the following is most likely to be considered as an indication of possible fraud?

- A. A new management team installed as the result of a takeover.
- B. Rapid turnover of financial executives.
- C. Rapid expansion into new markets.
- D. Tax authorities' audit of tax returns.

Correct Answer: B

QUESTION 45

The universal audit approach requires all companies to prepare accounts for their shareholders,

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