Chapter 2

Overview of Integrated Audit

TRUE/FALSE

1. [LO 1] Publically-traded company refers to any SEC registrant.
2. [LO 1] The PCAOB oversees the securities markets.
3. [LO 2] The integrity of management plays a key role in deciding whether or not to accept a client.
4. [LO 2] A client keeps his records in a shoebox with little evidence supporting the entries. This is sufficient to support conclusions in generating an audit report.
5. [LO 3] The auditor begins with tests of internal control.
6. [LO 4] One of the fundamental concepts concerns valuation and allocation.
7. [LO 4] All assertions apply to every account.
8. [LO 5] An audit firm must submit a proposal if a potential new client inquires about their audit services.
9. [LO 5] The contract between the audit firm and client is called the engagement letter.
10. [LO 5] The planning process begins with an evaluation of entry level controls.
11. [LO 5] Analytical procedures pinpoint the exact location of fraud.
12. [LO 6] An audit of a non-public firm is identical to that for a public firm.
13. [LO 6] The auditor assesses the internal controls of a non-public client for the purpose of planning.
14. [LO 7] Generally accepted auditing standards refer to those standards that have been adopted by the PCAOB.
15. [LO 7] The AICPA generates all field standards.

MULTIPLE CHOICE

16. [LO 1] If the auditor disagrees with management's assertion of internal control, the auditor:
    (a) ignores this and issues the proper opinion.
    (b) notes this in the footnotes.
    (c) notes this in the audit report.
    (d) None of the above.

17. [LO 1] Who issues standards for audits of non-public companies?
    (a) The AICPA.
    (b) The SEC.
    (c) The PCAOB.
    (d) All of the above.

18. [LO 1] The process of client acceptance or continuance involves:
    (a) deciding whether the auditor is willing to audit the client.
    (b) wants the firm as a client.
    (c) can do a good job auditing the client.
    (d) All of the above.

19. [LO 2] An integrated audit consists of:
    (a) examining the effectiveness of internal control.
    (b) examining the fairness of the financial statements.
    (c) Both a and b.
    (d) Neither a nor b.

20. [LO 2] If an entity's financial records do not contain sufficient evidentiary matter the auditor must:
    (a) issue a qualified opinion.
    (b) decline the audit.
    (c) perform the audit and obtain the evidence itself.
    (d) None of the above.

21. [LO 3] The audit is concluded with:
    (a) the audit opinion on the financial statements.
    (b) the audit opinion on the ICFR.
    (c) wrap-up procedures.
    (d) All of the above.

22. [LO 3] Planning an audit involves which of the following steps:
    (a) risk assessment.
    (b) collecting information concerning the client's information system.
    (c) collecting information about the client.
    (d) All of the above.

23. [LO 3] Information system refers to:
    (a) the client's accounting information system.
    (b) the system by which management collects and analyzes information.
    (c) the computer system used by the client.
    (d) Both a and b.

24. [LO 3] For public companies, the auditor also reviews which of the following on a regular basis:
    (a) the 10Qs filed quarterly with the SEC.
    (b) the 8-Ks (if filed) with the SEC.
    (c) the 10Ks filed annually with the SEC.
    (d) All of the above.

25. [LO 3] The ICFR is important because:
    (a) it links the client's financial statements and the risks associated with financial reporting.
    (b) it links the information system and the risks associated with financial reporting.
    (c) it provides readers with an assessment of how effective the internal control system is.
    (d) All of the above.

26. [LO 3] Assessing the design effectiveness of the internal control system involves:
    (a) reviewing the controls that are missing.
    (b) reviewing the controls present.
    (c) deciding if those controls are operating as intended.
    (d) All of the above.

27. [LO 3] Assessing the design effectiveness of the internal control system involves:
    (a) determining if the controls are appropriate.
    (b) determining if the controls operate as designed.
    (c) determining who is responsible for internal control.
    (d) All of the above.

28. [LO 3] If the auditor decides that the internal controls are not designed appropriately then:
    (a) the auditor tests those controls in-depth.
    (b) the auditor performs tests of internal control for those transactions and accounts deemed risky.
    (c) the auditor performs substantive procedures.
    (d) All of the above.

29. [LO 3] The auditor's finding with respect to internal control is:
    (a) assessed at the beginning of the audit as part of the ICFR review.
    (b) assessed during substantive testing procedures.
    (c) assessed during testing of internal control.
    (d) All of the above.

30. [LO 3] If the auditor initially considers the internal control environment risky, but later during the audit concludes it to be adequate as a result of substantive procedures, the auditor:
    (a) should reflect the new assessment in its report on ICFR.
    (b) should increase substantive testing.
    (c) should issue a new opinion on the financial statements.
    (d) should issue a new opinion on the ICFR.

31. [LO 4] Management assertions contain which of the following:
    (a) statements concerning that accounts exist.
    (b) statements that all liabilities are included in the balance sheet.
    (c) statements that the financial statements are presented fairly.
    (d) All of the above.

32. [LO 4] The balance sheet for a client shows a balance of $5,000. This is an example of which assertion:
    (a) completeness.
    (b) right and obligations.
    (c) valuation and allocation.
    (d) All of the above.

33. [LO 4] Which of the following assertions would not apply to short-term debt:
    (a) existence.
    (b) completeness.
    (c) right and obligations.
    (d) All of the above.

34. [LO 4] The reason auditors collect evidence is to:
   (a) determine if management's assertions are fair.
   (b) obtain a reasonable basis for forming an opinion on the financial statements.
   (c) obtain a reasonable basis for forming an opinion on the effectiveness of ICFR.
   (d) All of the above.

35. [LO 4] Which assertion(s) is met if proper cut-off is achieved:
   (a) right and obligations.
   (b) completeness.
   (c) existence or occurrence.
   (d) Both b and c.

36. [LO 4] Which of the following assertions address presentation and disclosure:
   (a) existence.
   (b) accuracy and valuation.
   (c) rights and obligations.
   (d) Both b and c.

37. [LO 4] Which of the following assertions address account balances at the period end:
   (a) completeness.
   (b) right and obligations.
   (c) existence.
   (d) All of the above.

38. [LO 4] Which of the following assertions do ***NOT*** address classes of transactions and events for the period under audit:
   (a) rights and obligations.
   (b) completeness.
   (c) cut-off.
   (d) None of the above.

39. [LO 4] The amount of evidence collected during an audit has a direct relationship to:
   (a) expected risk.
   (b) accuracy of management assertions.
   (c) appropriateness of management assertions.
   (d) All of the above.

40. [LO 4] In order to obtain evidence regarding valuation of accounts receivable, the auditor is likely to:
    (a) send out confirmations to the client's debtors requesting amount owed verification.
    (b) inquire of management as to the accuracy of sales transactions.
    (c) examine completed confirmation requests for discrepancies between debtor and client amount.
    (d) All of the above.

41. [LO 4] Which of the below depicts the correct path of action an auditor takes in assessing assertions:
    (a) management assertions—audit procedures—risk assessment.
    (b) management assertions—risk assessment—audit evidence.
    (c) management assertions—risk assessment—audit procedures.
    (d) management assertions—material risk assessment—audit procedures.

42. [LO 4] Due professional care applies to:
    (a) sample selection.
    (b) follows appropriate audit standards.
    (c) accepts professional guidance.
    (d) All of the above apply to due professional care.

43. [LO 4] An auditor selects a sample using a random number generator, even though she believes the account being audited presents increased risk. This is a violation of:
    (a) professional care.
    (b) professional skepticism.
    (c) Both a and b.
    (d) Neither a nor b.

44. [LO 4] Judgment errors indicate:
    (a) the auditor behaved in a negligent manner.
    (b) the auditor failed to exhibit professional care.
    (c) the auditor failed to exhibit professional skepticism.
    (d) None of the above.

45. [LO 4] Absolute assurance:
    (a) is desired and strived for by auditors.
    (b) is not cost-effective.
    (c) is not possible given the estimation of many numbers in the financial statements.
    (d) Both b and c.

46. [LO 4] Evidence must be:
   (a) sufficient.
   (b) persuasive.
   (c) convincing.
   (d) Both a and b.

47. [LO 4] To come to an opinion on management's assertions, an auditor must:
   (a) obtain evidence in writing.
   (b) obtain evidence that is convincing.
   (c) obtain evidence that is appropriate and reliable.
   (d) All of the above.

48. [LO 4] Which of the following source of evidence would be the most reliable:
   (a) a written confirmation sent by a bank directly to the auditor.
   (b) a written confirmation sent by a debtor to the client.
   (c) a written document produced electronically by a client with good internal controls.
   (d) a written document in the form of a fax sent by a debtor to the client indicating acceptance of a special offer.

49. [LO 4] Auditors do not provide absolute assurance in an audit due to
   (a) Financial statement numbers are based on estimates.
   (b) Auditors usually examine a sample rather than all of a company's transactions.
   (c) Those who commit fraud go to great lengths to conceal their actions.
   (d) All of the above.

50. [LO 4] Audit risk is defined as:
   (a) the risk that the client is committing fraud.
   (b) the risk associated with a specific client.
   (c) the risk that the auditor fails to detect a material misstatement.
   (d) All of the above.

51. [LO 4] Audit risk involves:
   (a) only the financial statements.
   (b) only the ICFR.
   (c) both the financial statements and ICFR.
   (d) only cases where fraud exists.

52. [LO 4] Materiality decisions are based on:
   (a) qualitative factors.
   (b) quantitative factors.
   (c) the audit fees.
   (d) Both a and b.

53. [LO 4] An auditor encounters an error and decides not to suggest an adjustment. This is an example of:
    (a) professional skepticism.
    (b) professional judgment.
    (c) materiality decision.
    (d) Both b and c.

54. [LO 4] An example of qualitative materiality is:
    (a) an error involving an amount of great magnitude.
    (b) an error involving management oversight of small amounts.
    (c) a misstatement caused by management fraud.
    (d) All of the above.

55. [LO 4] If an auditor concludes the financial statements contain only immaterial errors, then the auditor should:
    (a) correct the errors.
    (b) have the client correct the errors.
    (c) issue an unqualified ("clean") opinion on the financial statements.
    (d) issue a qualified opinion on the financial statements.

56. [LO 5] As part of the proposal process the auditor:
    (a) determines if the potential client is a good fit.
    (b) determines of the auditor can perform an effective audit.
    (c) determines if the potential client management is reputed to be of good character.
    (d) All of the above.

57. [LO 5] Which of the following could cause an auditor to refuse to submit a proposal for a prospective audit client:
    (a) a senior sales V.P.'s 10 year-old conviction for tax evasion.
    (b) a board of directors comprised of management's close friends.
    (c) a reputation for high employee turnover.
    (d) None of the above.

58. [LO 5] Engagement risk is defined as:
    (a) the risk that the client will not pay you on time.
    (b) the risk that being associated with the client will not be good for the accounting firm.
    (c) the risk that the client will not reappoint the auditor after the first year.
    (d) All of the above.

59. [LO 5] The engagement letter:
  (a) must be generated before any audit work is performed.
  (b) cannot be generated until the audit firm communicates with the audit committee, in writing, about independence.
  (c) includes the names of staff and managers working on the engagement.
  (d) All of the above.

60. [LO 5] Which of the below is an example of an inherent risk:
  (a) the risk that the economy will sink into recession.
  (b) the risk that the firm will be a take-over target.
  (c) the risk that a particular financial statement account is incorrect.
  (d) All of the above.

61. [LO 5] Control risk is:
  (a) the risk that inventory will not be sold.
  (b) the risk that the internal controls will not disclose material errors.
  (c) the risk that the economy will sink into recession.
  (d) the risk that accounts receivable will be uncollected.

62. [LO 5] Detection risk is:
  (a) the possibility that a misstatement will be missed when audit steps are performed.
  (b) the possibility that accounts receivable will be uncollected.
  (c) the possibility that inventory will not be sold.
  (d) Both b and c.

63. [LO 6] Non public companies:
  (a) do not have to be audited.
  (b) are not required to have an audit of their ICFR.
  (c) follow different standards than public companies.
  (d) present little, if any, risk to auditors.

64. [LO 6] Auditors auditing nonpublic companies must follow:
  (a) all audit standards.
  (b) only those standards issued by the PCAOB.
  (c) only those standards issued by the AICPA.
  (d) None of the above.

65. [LO 7] GAAS refers to:
  (a) ten auditing standards grouped into three sections.
  (b) those auditing standards that apply only to audits of public companies.
  (c) accounting principles generally accepted.
  (d) None of the above.

66. [LO 7] The three sections or groups of audit standards are:
   (a) field work, general, and final.
   (b) field work, reporting, and general.
   (c) field work, testing, and internal control review.
   (d) field work, general, and overall.

67. [LO 7] Auditing Standard #5 requires:
   (a) auditors perform tests of internal control.
   (b) auditors have technical competence to perform audits.
   (c) auditors exercise professional skepticism.
   (d) Both b and c.

68. [LO 7] The field work standards address:
   (a) due professional care.
   (b) independence.
   (c) attention to GAAP.
   (d) obtaining sufficient evidential matter.

69. [LO 7] The reporting standards addresses:
   (a) an expression of an opinion.
   (b) independence.
   (c) supervision.
   (d) understanding of internal control.

70. [LO 7] Which of the following would be a violation of the general auditing standards:
   (a) the auditor accepts an engagement from a firm for whom his brother-in-law works as the controller.
   (b) the auditor hires marketing majors because it cannot afford accounting graduates but trains them thoroughly.
   (c) the auditor allows second-year staff to supervise beginning staff.
   (d) All of the above are violations.

MATCHING

71. Match the scenario below with the audit standard(s) and the number within the standard (e.g. General #1). Some examples may have more than one standard that applies.
    Audit standards:
        General #1, #2, or #3
        Field work #1, #2, or #3
        Reporting #1, #2, #3, or #4

SCENARIOS:

(a) Larry works for a CPA firm that has few supervisory auditors.

(b) Mary-Ellen becomes bored with auditing payroll, so she simply checks off the steps on a work program as being completed without doing the work.

(c) Bruce refuses to attend his firm's training sessions, attending a baseball game instead. He has another staff member sign him in and out.

(d) The audit firm runs out of time and thus stops collecting evidence despite worries that there might be errors in one account.

(e) The staff at a firm like the client, so they raise the materiality threshold beyond the limit generally set by the firm.

(f) The audit report states that GAAP was used in preparing the financial statements, even though the client deviated from GAAP in several material respects.

(g) The auditors withhold the audit report because they have not been paid.

(h) The auditors perform the tests of internal control as they perform the substantive tests in order to save the client money.

(i) The client changes accounting methods with respect to inventory, but failed to restate its financial statements for the prior periods. The auditors decided to let it go since they ran out of time.

(j) The auditors fail to audit the footnote disclosures provided by the client.

(k) The auditor is concerned that there are material errors he has not found and so refuses to issue an audit report.

SHORT ANSWER

72. List the steps required in client acceptance, in exact order. Also include important factors the auditor would consider in deciding whether or not to accept the client.

73. Describe in detail the audit steps required in performing an audit from beginning to end. Identify how you would address each of the auditing standards in your work.

DICUSSION QUESTIONS FROM THE TEXTBOOK

74. (2-21, LO 3, 4) What is the value of auditors going through a formal process of linking management assertions to audit procedures to collect evidence? How does this process improve the audit?

75. (2-25, LO 4) Is it possible that an auditor can make a professional judgment error and still be behaving with due professional care? Explain.

76. (2-28, LO 5) Why are analytical procedures a required step in audit planning?

PROBLEMS FROM THE TEXTBOOK

77. (2-31, LO 6) You are the auditor for a nonpublic company, "A Golden Rule Carpentry." The company has a 12/31 fiscal year end. During your audit, you did not identify any material misstatements in the financial statements.
Required:
(a) Draft the appropriate audit report for the financial statement audit of"A Golden Rule Carpentry."
(b)What assurances are provided in the audit report when the auditor states that the financial statements "present fairly ...in conformity with accounting principles generally accepted in the United States of America"?
(c)How does the audit report refer to materiality, and how does it relate to your response to (b)?
(d)How do you think the auditor should respond upon finding a misstatement that he or she believes is material, and the client disagrees? In other words, client management believes the misstatement is not material?

78. (2-32, LO 4) For each of the following accounts, list the five management assertions from most to least important for that account. State the reason justifying your order. Cash is completed as an example.

(a) Cash (in home currency)
1. Existence
2. Rights
3. Presentation and disclosure
4. Completeness
5. Valuation

If cash does not exist, then none of the other assertions matter. However, even if cash is found to exist, it has to be owned by the company claiming it. Various disclosures can be required for cash, for example, if it is committed as a compensating balance. Completeness is not a big audit risk because it is unlikely that management would not report cash or that any amount omitted is material. Cash is reported at face value, so valuation is not an issue for cash unless it is in a foreign currency.

(b) Long term debt
(c) Officer salary expense paid through stock options
(d) Sales revenue
(e) Accounts receivable
(f) Property, plant and equipment

79. (2-38, LO 5) Arin Pate, CPA, is scheduled to work on the integrated audits of two client companies in the coming month: Jacoh Industries and Morton Baxx, Ltd. Arin was assigned to both of these audit engagements in the prior year. As she works on the preliminary audit planning phase, Arin notes the following facts and features pertaining to each of these client companies: Jacoh Industries is a manufacturer of medical imaging equipment. Although Jacoh's equipment is distributed worldwide, the company operates at a single location. The equipment is promoted through sales teams, and sales are accepted through an online ordering system. There is a significant investment in inventories, and internal control in this area is strong. In fact, Arin's firm has never had any significant audit differences or disagreements with the client. Within the past year, however, a new competitor has entered the market, and Jacoh is experiencing a decline in sales volume. Although the company's income statement still shows a slight profit, cash flow challenges are now prevalent. Jacoh, however, has not suffered as much as several other competitors, who are reporting losses for the first time. Morton Baxx publishes a monthly fashion magazine. Subscription revenues and many of the advertising revenues are deferred. Most subscriptions are sold on an annual basis, but advertising contracts range from one month to one year. Publishing costs are typically recorded in the period that they are incurred. MortonBaxx's internal controls have been effective in the past.

Required: In order to minimize audit risks on each of these audit engagements, what audit areas should Arin emphasize?

SOLUTIONS

TRUE/FALSE

1. T
2. F
3. T
4. F
5. F
6. T
7. F
8. F
9. T
10. T
11. F
12. F
13. T
14. T
15. F

MULTIPLE-CHOICE

16. c
17. a
18. d
19. c
20. b
21. d
22. d
23. d
24. d
25. d
26. b
27. a
28. c
29. d
30. a
31. d
32. d
33. c
34. d
35. d
36. d
37. d
38. a
39. d
40. d

41. d
42. d
43. d
44. d
45. d
46. d
47. c
48. a
49. d
50. c
51. c
52. d
53. d
54. c
55. c
56. d
57. a
58. b
59. b
60. c
61. b
62. a
63. b
64. c
65. a
66. b
67. d
68. d
69. a
70. a

MATCHING

71. (a) Field work #1
    (b) General #3 (could also be Field work #1)
    (c) General #3 and Field work #1
    (d) General #3 and Field work #3
    (e) General #2 and General #3
    (f) Reporting #1
    (g) General #2
    (h) Field work #2
    (i) Reporting #2
    (j) Reporting #3
    (k) Reporting #4

SHORT ANSWER

72. Upon receiving a request for a proposal, perform background work on the client and its key personnel to determine if ethical issues exist (such as a history of misconduct, etc.) and if the audit firm can trust the personnel.

    Next, perform a review to determine if the firm has the required resources and staff to undertake the assignment. Items to consider: complex transactions, industry of prospective client, etc. Determine if the client would be a good fit and if the firm could provide a good, meaning quality audit. Perform an analytical review of the firm and benchmark it with others in the industry.

    Finally, review the prospective client's audit committee and board of directors. Review the backgrounds of each member and determine if enough independent oversight exists in these bodies for the auditor to feel comfortable.

    Assuming that the auditor decides it wants the firm as a client, then and only then, would it complete a proposal.

73. Plan the audit
    Perform analytical review
    Review the client's ICFR
    Determine testing necessary to audit the ICFR
    Perform tests of internal controls
    Determine the effectiveness of internal control
    Based on those tests, plan the substantive field work
    Obtain evidentiary matter
    Re-adjust audit testing, if necessary based on results of substantive work
    Review accounting treatment for adherence to GAAP
    Review for materiality
    Recommend adjustments for material error/misstatements
    Perform review of audit work
    Review work performed by staff
    Review for qualitative materiality as well as quantitative materiality issues
    Generate audit report

SOLUTIONS TO DISCUSSION QUESTIONS IN TEXTBOOK

74. (2-21, LO3, 4)

The linkage is as follows: Management makes assertions regarding the financial statements. Specific risks exist that may threaten the appropriateness of those assertions. The auditor addresses the possibility that those risks have actually caused the assertions to be invalid by using various audit procedures, and those audit procedures result in the auditor collecting evidence. This formal linking clarifies the purpose of each audit step conducted and increases the likelihood that the auditor collects sufficient, appropriate evidence to determine whether management's assertions are valid.

75. (2-25, LO4)

Yes. Behaving with due professional care means that the auditor is following all the auditing guidance and is exercising professional judgment while having an unbiased frame of mind, but still underpinning judgments with professional skepticism. The fact that the auditor has to use professional judgment means that he or she must make decisions. Humans are fallible, even when they are careful. Therefore, just because an auditor makes a judgment error does not mean he or she was negligent.

76. (2-28, LO5)

Analytical procedures can give the auditor a "big picture" view of a company. In a first year audit, analytical procedures during planning show the auditor areas that are most important to a client company, and those that may be of high risk because they are different from what is expected. In subsequent year audits, analytical procedures during planning can show the auditor what has changed from the prior year or from expected trends. This information helps the auditor identify risk areas and areas that will require more audit effort. Based on this information the auditor can plan the audit to direct audit resources to collect sufficient, appropriate evidence.

SOLUTIONS TO PROBLEMS IN THE TEXTBOOK

77. (2-31)

(a)

Independent Auditor's Report

We have audited the accompanying balance sheets of A Golden Rule Carpentry, Inc. as of December 31, 2011 and 2010, and the related statements of income, retained earnings, and cash flows for the years then ended. These financial statements are the responsibility of A Golden Rule Carpentry, Inc.'s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of A Golden Rule Carpentry, Inc. as of December 31, 2011 and 2010, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Hooks and Walker, CPAs
March 13, 2012

(b)
The assurances are that the financial statements reflect the company's financial position and economic events for the date and period report and that they conform with GAAP in all material respects. In other words the financial statements are not materially misstated, either from error or fraud.

(c)
The main reference to materiality is stating that the financial statements are fair in all material respects. The auditor also relies on the concept of materiality when stating that the audit provides reasonable assurance. The auditor is not absolutely sure about the fairness of the financial statements. However, the auditor can be reasonably sure that there is nothing wrong with the financial statements that surpasses a materiality threshold.

(d)
The auditor should re-investigate the item(s) thought to be misstated to be sure the audit evidence is correct. The auditor discusses the finding with the client. If, after discussion, the auditor still believes the financial statements are materially misstated and the client company will not change them, the auditor must issue an audit report that is modified from a clean or unqualified opinion.

78. (2-32)

(a) Cash (in home currency)

a. Existence
b. Rights
c. Presentation and disclosure
d. Completeness
e. Valuation

If cash does not exist, then none of the other assertions matter. However, even if cash is found to exist, it has to be owned by the company claiming it. Various disclosures can be required for cash, for example, if it is committed as a compensating balance. Completeness is not a big audit risk because it is unlikely that management would not report cash or that any amount omitted is material. Cash is reported at face value so valuation is not an issue for cash unless it is in a foreign currency.

(b) Long term debt

a. completeness
b. valuation
c. presentation and disclosure
d. rights and obligations
e. existence

The biggest audit risks are that all debt is shown, that it is properly valued according to GAAP and that it is classified and disclosed properly in the financial statements. Leaving out debt or not showing it at the proper amount – or properly classified as long or short term -- would be of greatest concern to financial statement users. Because debt requires a lot of specific disclosure, the auditor is then concerned that the notes are proper. The auditor is far less concerned that the company would include debt that is not actually the company's obligation or that it would include debt that does not exist. These would reduce the net value of the balance sheet, so although they are misstatements, they would undervalue rather than overvalue.

(c) Officer salary expense paid through stock options

a. completeness
b. valuation
c. rights and obligations
d. presentation and disclosure
e. existence

The order of the audit concerns are similar to those of debt. The auditor wants to be sure that all the officer compensation is recorded, but to do that, since it is paid through stock options it will likely have to be valued. The valuation can be complex, using stock valuation models. Any obligations that the company has as a result of these stock compensation transactions is also important. These obligations dilute earnings per share so the auditor is concerned that the obligations are properly posted. Presentation and disclosure is important because the disclosure is extensive. Also, those who follow a company's stock pay a lot of attention to EPS so the auditor wants to be sure it is shown properly. (Note that for the presentation and disclosure to be proper, the completeness, valuation and obligation assertions must be proper.) The auditor is least concerned about existence, because if the company records compensation expense and a stock option effect that does not exist it understates net income and net assets.

(d) Sales revenue
a. occurrence
b. valuation
d. presentation and disclosure
d. completeness
e. rights
The greatest audit risk for revenue is that it really occurred and that it is recorded at the proper value. For straightforward sales, occurrence and valuation are easy to verify, with the primary risk being that a sale is fraudulent. For more complex sales transactions, such as those recognized over time, bill and hold, etc. determining when the sale occurred and how much to recognize can be more difficult and the auditor needs to determine that recognizing the revenue is justified. Presentation and disclosure are also straightforward unless the nature of the sales transaction is complex. Completeness is a lower audit concern because the misstatement would understate income – however, it is still a concern because if it is misstated it can affect more than one year. The rights assertion is a greater concern related to the receivables that can result from a sales transaction, rather than the sales themselves.

(e) Accounts receivable
a. existence
b. valuation
c. rights
d. presentation and disclosure
e. completeness

The three top audit concerns all go together. Do the accounts receivable really exist? Has collectability been properly estimated so that the net value shown is materially fair? Does the company have (or still have) rights to the receivables? Examples of the issues that the auditor addresses: Can the sales be returned for a full refund, and if so, have (1) the returns been properly estimated and (2) sales and receivables properly reduced for the estimated returns? How has the allowance for doubtful accounts been estimated? Is the approach valid and has it been carried out properly? Does the company still own the receivables? Presentation and disclosure is straightforward but certain items must be disclosed. Again, completeness is last on the list of assertion concerns because if all the accounts receivable are not shown the misstatement is conservative and understates net book value.

(f) Property, plant and equipment
a. existence
b. valuation
c. rights
d. presentation and disclosure
e. completeness
Property, plant and equipment is generally a low risk area. The auditor is concerned that items that should have been expensed have not been capitalized (existence), that the net value is proper – after depreciation is calculated. The rights assertion is addressed along with existence – if the company has possession of something and states that it owns it, did it pay for it? Presentation and disclosure is fairly straightforward, but the schedules required in the notes can be lengthy for some companies. Since PP&E is an asset, completeness is not a significant risk.

79. (2-38)
For Jacoh, since internal control is strong and there has been no change in the company's operations, there is likely a low risk of unintentional errors. However, given the decline in financial results and the problems in the competitive arena, there is a greater risk that management may attempt to conceal losses. Arin should emphasize the existence and valuation assertions for sales and inventories to detect possible overstatement of these accounts.

For Morton Baxx, since internal control is strong and there has been no change in the company's operations, there is likely a low risk of unintentional errors. However, given the complex nature of the deferrals related to revenue recognition, Arin should emphasize the valuation and allocation assertion. Supporting evidence for subscription revenues and advertising contracts should be carefully examined to make sure that the matching concepts being applied properly. This should be consistent with the prior year approach.