

Test Bank For

Auditing, 11th Edition by Alan Millichamp, John Taylor

Chapter 1-32 With Practice Exam

AUDITING MILLICHAMP & TAYLOR ANSWER to PRACTICE EXAM

1. Which of these statements is true?

An audit benefits a company because

- a) It reassures the shareholders that the accounts are accurate
- b) Makes the management accountable to the shareholders
- c) Guarantees that the accounts are free from fraud or error
- d) Guarantees that the financial information shown is true and fair

Answer d)

2 Explain the responsibilities of

- the directors
- the auditors

in connection with the preparation and publication of a company's financial statements

Answer

The directors are responsible for producing 'true and fair' accounts; the auditors simply express their opinion on them. The directors are the individuals who, collectively, have to present an accounting of their dealings with the shareholder's assets in as balanced and impartial a way as possible. It is their task to explain themselves in a way that can be understood and that represents what actually happened in the financial period.

The primary audit objective is to gather sufficient reliable evidence so as to be able to express an opinion, in the form of a report to the shareholders, of the

truth and fairness of a set of financial statements prepared by the directors so that any person reading and using them can have confidence in them.

3. Explain in no more than 200 words The Theory of Rational Expectations developed by Professor Limperg

Answer

The theory holds that the value of the auditor's report derives from the expert nature of the auditor as an independent, competent professional. Broadly this is a dynamic theory which holds that, as the business community changes, so the expectations it has of the auditors' function also changes.

The theory holds that the work carried out by the auditor should be governed by the rational expectations of those who use their reports so auditors should not disappoint those expectations. Further, auditors should not seek to raise those expectations by any more than the work they do justifies.

4. State whether the following statements are true or false in respect of external auditors' responsibilities

- **Auditors are responsible for the financial content of the annual accounts** (false)
- **Auditors do not have to have absolute assurance that the figures they audit are correct** (true)

5 Mautz and Sharaf set out a series of postulates and assumptions on which their theory of auditing was based. Set out in not more than 500 words the basis of their approach and the problems which subsequent commentators have indicated with their approach. Note it is not necessary for you to set out the postulates in detail merely use them to indicate points in your answer where necessary.

Answer

Mautz & Sharaf held that auditing is based on scientific logic where the auditing process is a rational process of examination, observation and evaluation of evidence. The essence of Mautz and Sharaf's approach is that auditing practice should be built on a sound philosophy of auditing because basing actions on an underpinning philosophy means:

- going back to first principles of what an audit is, what purpose it serves and what usefulness it has for society,
- that knowledge has to be ordered in a systematic way, and it
- defines auditing's place in and usefulness to society.

Broadly Mautz and Sharaf adopted a scientific approach to auditing claiming that auditing practice, with its heavy emphasis on probability and a scientific approach to evidence, has much in common with scientific method.

Their theory did not take into account questions of risk, the exercise of judgement by auditors which is not part of a scientific approach and questions of accountability

6. Which one of the following best describes the role of the International Auditing and Assurance Board (IAASB)?

The IAASB is responsible for:

- a) Setting auditing standards which are compulsory throughout the world**
- b) Monitoring auditors to ensure that they comply with auditing standards**
- c) Investigating and disciplining auditors who fail to comply with auditing standards**
- d) Setting auditing standards which facilitate the convergence of national and international auditing standards**

Answer d)

7. Explain in not more than 200 words the basic principles of Agency Theory and the role the auditor plays

Agency theory is the recognition that the inclination of agents is to act rather more in their own interests than those of their employers, in this case the shareholders. What this means to us in practice is that agency theory recognized the tendency of company managers, or directors, to tend to make decisions which are more favourable to their own objectives than to those of their principals, in this case the owners, or shareholders, of the business.

The audit profession is a key part of the regulatory mechanism which holds agents accountable to their principals and which serves to validate their financial accounting of the use to which they have put the company's assets.

8. State the advantages and disadvantages of a framework approach to corporate governance as opposed to a legislative approach

Answer

Corporate Governance – principles based v legal approach	
Principles based	Legal approach
Lawyers spend time trying to get around the legal rules	Everyone knows where they are and should be able to apply the rules
The legal approach leads to a 'tick box' approach to corporate governance	Principles are hard to explain so can be vague and difficult to interpret
Principles based approaches can be applied to any jurisdiction and any legal system	Principles based approaches are difficult to enforce in any meaningful way without legislation or sanctions

You are the audit partner for BiglyBuilders plc a large UK construction company.

The financial director of BiglyBuilders has approached you and asked you if your firm would carry out the role of internal auditors as well as continuing to act as external auditors. The fee for this work would be