

## Table of Contents

Describe the three theoretical frameworks that have been proposed to explain why there is a demand for audit and assurance service. ....	3
What is the audit expectation gap? Give three examples of how this may be caused and outline two ways that this gap can be reduced .....	3
Briefly explain the five fundamental principles that professional accountants are expected to comply with, as outlined in APES110. Which would be the most significant one for an auditor? .....	4
Which is more important for an auditor, independence of mind or independence in appearance? Explain .....	4
What is an audit committee and what are they normally responsible for? Why is it important not have executive directors of the company as members of the audit committee? .....	5
Explain the significance of the Esanda (1997) case for auditors .....	5
Explain the significance of the Pacific Acceptance (1970) case for auditors .....	5
Explain the significance of the AWA (1992) case for auditors.....	6
Explain why is more difficult for third parties to successfully sue an auditor for negligence than it is for an audit client? Refer to relevant case law to support your answer.....	6
Under ASQC1, part of the process an auditor is required to undertake before accepting a new client, or continuing with an existing client, is to consider the client's "integrity". Explain how an auditor would do this? .....	7
Explain the importance of the risk assessment phase of a financial report audit? .....	7
List six "red flag" indicators that may indicate potential going concern risk.....	8
What is a "mitigating factor"? Give four examples of such factors.....	8
Explain what is meant by the term "audit strategy". What does the decision about strategy depend on? .....	8
Explain three factors that the auditor would need to consider before relying on analytical procedures during an audit .....	8
Compare and contrast the objectives of a "management representation letter" to those of a "management letter" .....	9
Why would an auditor be less likely to use accounts payable confirmations than accounts receivable confirmations? .....	9
Describe the two levels of controls that should exist in a good system of internal control. Explain why both levels are needed .....	9
What are entity-level controls. List the five components of entity-level controls, as outlined in ASA315? .....	10
Why would an auditor be interested in a client's control monitoring processes? .....	10
What is sampling risk? How can an auditor reduce this risk? .....	10
Explain the difference between the two types of sampling risk for controls testing. What are the implications of each of these for an auditor? Which is the more serious risk, and why? .....	11
What is non-sampling risk? Identify and explain two causes of non-sampling risk.....	11
Identify and explain 3 factors that would cause the auditor to increase their sample size when undertaking substantive tests .....	12

In general, how are controls selected for testing? Provide 3 examples of specific factors considered when deciding how much testing should be done on each control selected**	12
What are the four types of tests of controls? Comment on the relative reliability of each..	12
Explain the concept of benchmarking and its benefits to the auditor .....	13
Give an example of both vouching and tracing and provide the main assertion that each approach would be used to test .....	13
Explain “roll-forward” procedures. When are they appropriate for an auditor to use? .....	14
What are “subsequent events”? Outline 4 audit procedures that can be used to identify if such an event has occurred.....	14

Describe the three theoretical frameworks that have been proposed to explain why there is a demand for audit and assurance service.

#### Chapter 1

- The three theories are agency theory, the information hypothesis and insurance hypothesis.
  - **Agency theory** → Where an owner hires a manager to run the business on their behalf, with potential conflicts arising.
    - Due to the remoteness of the owners from the entity, the complexity of items included in the financial report and competing incentives between the owners and managers:
      - ✚ The owners have an incentive to hire an auditor to assess the truth and fairness of the information contained in the financial report prepared by the managers
      - ✚ Managers also have an incentive to hire an auditor to demonstrate to their shareholders that they have prepared true and fair financial reports free of fraud and error
  - **Information hypothesis** → Financial report users require access to high-quality information to make a variety of decisions, such as determining whether to lend money to the entity, what rate of interest to charge the entity on the money lent, etc. Therefore, the greater the perceived quality of the information contained in the financial report, the more likely it is relied upon by the users of the information.
    - Due to the demand for reliable, high-quality information, various user groups including shareholders, banks and other lenders will demand that financial reports be audited to aid their decision making.
  - **Insurance hypothesis** → Investors take on a risk when buying shares – if an entity fails, investors could lose the money invested, hence, an audit for investors could insure against at least part of their loss should the company they invest in fail.
    - Investors will demand the financial reports be audited as a way of insuring against some of their loss should their investment fail.

What is the audit expectation gap? Give three examples of how this may be caused and outline two ways that this gap can be reduced

#### Chapter 1

- The audit expectation gap occurs when there is a difference between the expectations of assurance providers and financial report users. The gap occurs when user beliefs do not align with what an auditor has actually done.
- The gap is caused by unrealistic user expectations such as:
  - The auditor providing complete assurance
  - The auditor is guaranteeing the future viability of the entity
  - An unmodified audit opinion is an indicator of complete accuracy
  - The auditor will definitely find any fraud
  - The auditor has checked all transactions
- The audit expectation gap can be reduced by:
  - Auditors performing their duties appropriately, complying with auditing standards and meeting the minimum standards of performance that should be expected of all auditors
  - Peer reviews of auditors to ensure that auditing standards have been applied correctly
  - Education of the public