Chapter 1—Auditing and Internal Control

TRUE/FALSE

1. Corporate management (including the CEO) must certify monthly and annually their organization's internal controls over financial reporting.

   ANS: F PTS: 1

2. Both the SEC and the PCAOB require management to use the COBIT framework for assessing internal control adequacy.

   ANS: F PTS: 1

3. Both the SEC and the PCAOB require management to use the COSO framework for assessing internal control adequacy.

   ANS: F PTS: 1

4. A qualified opinion on management's assessment of internal controls over the financial reporting system necessitates a qualified opinion on the financial statements?

   ANS: F PTS: 1

5. The same internal control objectives apply to manual and computer-based information systems.

   ANS: T PTS: 1

6. The external auditor is responsible for establishing and maintaining the internal control system.

   ANS: F PTS: 1

7. Segregation of duties is an example of an internal control procedure.

   ANS: T PTS: 1

8. Preventive controls are passive techniques designed to reduce fraud.

   ANS: T PTS: 1

9. The Sarbanes-Oxley Act requires only that a firm keep good records.

   ANS: F PTS: 1

10. A key modifying assumption in internal control is that the internal control system is the responsibility of management.

    ANS: T PTS: 1

11. While the Sarbanes-Oxley Act prohibits auditors from providing non-accounting services to their audit clients, they are not prohibited from performing such services for non-audit clients or privately held companies.

    ANS: T PTS: 1

12. The Sarbanes-Oxley Act requires the audit committee to hire and oversee the external auditors.

    ANS: T PTS: 1

13. Section 404 requires that corporate management (including the CEO) certify their organization's internal controls on a quarterly and annual basis.

    ANS: F PTS: 1

14. Section 302 requires the management of public companies to assess and formally report on the effectiveness of their organization's internal controls.

    ANS: F PTS: 1

15. Application controls apply to a wide range of exposures that threaten the integrity of all programs processed within the computer environment.

    ANS: F PTS: 1

16. IT auditing is a small part of most external and internal audits.

    ANS: F PTS: 1

17. Advisory services is an emerging field that goes beyond the auditor's traditional attestation function.

    ANS: T PTS: 1

18. An IT auditor expresses an opinion on the fairness of the financial statements.

    ANS: F PTS: 1

19. External auditing is an independent appraisal function established within an organization to examine and evaluate its activities as a service to the organization.

    ANS: F PTS: 1

20. External auditors can cooperate with and use evidence gathered by internal audit departments that are organizationally independent and that report to the Audit Committee of the Board of Directors.

    ANS: T PTS: 1

21. Tests of controls determine whether the database contents fairly reflect the organization's transactions.

    ANS: F PTS: 1

22. Audit risk is the probability that the auditor will render an unqualified opinion on financial statements that are materially misstated.

    ANS: T PTS: 1

23. A strong internal control system will reduce the amount of substantive testing that must be performed.

    ANS: T PTS: 1

24. Substantive testing techniques provide information about the accuracy and completeness of an application's processes.

    ANS: F PTS: 1

MULTIPLE CHOICE

1. The concept of reasonable assurance suggests that
   a. the cost of an internal control should be less than the benefit it provides
   b. a well-designed system of internal controls will detect all fraudulent activity
   c. the objectives achieved by an internal control system vary depending on the data processing method
   d. the effectiveness of internal controls is a function of the industry environment

   ANS: A PTS: 1

2. Which of the following is not a limitation of the internal control system?
   a. errors are made due to employee fatigue
   b. fraud occurs because of collusion between two employees
   c. the industry is inherently risky
   d. management instructs the bookkeeper to make fraudulent journal entries

   ANS: C PTS: 1

3. The most cost-effective type of internal control is
   a. preventive control
   b. accounting control
   c. detective control
   d. corrective control

   ANS: A PTS: 1

4. Which of the following is a preventive control?
   a. credit check before approving a sale on account
   b. bank reconciliation
   c. physical inventory count
   d. comparing the accounts receivable subsidiary ledger to the control account

   ANS: A PTS: 1

5. A well-designed purchase order is an example of a
   a. preventive control
   b. detective control
   c. corrective control
   d. none of the above

   ANS: A PTS: 1

6. A physical inventory count is an example of a
   a. preventive control
   b. detective control
   c. corrective control
   d. Feed-forward control

   ANS: B PTS: 1

7. The bank reconciliation uncovered a transposition error in the books. This is an example of a
   a. preventive control
   b. detective control
   c. corrective control
   d. none of the above

   ANS: B PTS: 1

8. Which of the following is not an element of the internal control environment?
   a. management philosophy and operating style
   b. organizational structure of the firm
   c. well-designed documents and records
   d. the functioning of the board of directors and the audit committee

   ANS: C PTS: 1

9. Which of the following suggests a weakness in the internal control environment?
   a. the firm has an up-to-date organizational chart
   b. monthly reports comparing actual performance to budget are distributed to managers
   c. performance evaluations are prepared every three years
   d. the audit committee meets quarterly with the external auditors

   ANS: C PTS: 1

10. Which of the following indicates a strong internal control environment?
    a. the internal audit group reports to the audit committee of the board of directors
    b. there is no segregation of duties between organization functions
    c. there are questions about the integrity of management
    d. adverse business conditions exist in the industry

    ANS: A PTS: 1

11. According to COSO, an effective accounting system performs all of the following except
    a. identifies and records all valid financial transactions
    b. records financial transactions in the appropriate accounting period
    c. separates the duties of data entry and report generation
    d. records all financial transactions promptly

    ANS: C PTS: 1

12. Which of the following is the best reason to separate duties in a manual system?
    a. to avoid collusion between the programmer and the computer operator
    b. to ensure that supervision is not required
    c. to prevent the record keeper from authorizing transactions
    d. to enable the firm to function more efficiently

    ANS: C PTS: 1

13. Which of the following is not an internal control procedure?
    a. authorization
    b. management's operating style
    c. independent verification
    d. accounting records

    ANS: B PTS: 1

14. The decision to extend credit beyond the normal credit limit is an example of
    a. independent verification
    b. authorization
    c. segregation of functions
    d. supervision

    ANS: B PTS: 1

15. When duties cannot be segregated, the most important internal control procedure is
    a. supervision
    b. independent verification
    c. access controls
    d. accounting records

    ANS: A PTS: 1

16. An accounting system that maintains an adequate audit trail is implementing which internal control procedure?
    a. access controls
    b. segregation of functions
    c. independent verification
    d. accounting records

    ANS: D PTS: 1

17. The importance to the accounting profession of the Sarbanes-Oxely Act is that
    a. bribery will be eliminated
    b. management will not override the company's internal controls
    c. management are required to certify their internal control system
    d. firms will not be exposed to lawsuits

    ANS: C PTS: 1

18. The board of directors consists entirely of personal friends of the chief executive officer. This indicates a weakness in
    a. the accounting system
    b. the control environment
    c. control procedures
    d. this is not a weakness

    ANS: B PTS: 1

19. The office manager forgot to record in the accounting records the daily bank deposit. Which control procedure would most likely prevent or detect this error?
    a. segregation of duties
    b. independent verification
    c. accounting records
    d. supervision

    ANS: B PTS: 1

20. Control activities under SAS 109/COSO include
    a. IT Controls, preventative controls, and Corrective controls
    b. physical controls, preventative controls, and corrective controls.
    c. general controls, application controls, and physical controls.
    d. transaction authorizations, segregation of duties, and risk assessment

    ANS: C PTS: 1

21. Internal control system have limitations. These include all of the following except
    a. possibility of honest error
    b. circumvention
    c. management override
    d. stability of systems

    ANS: D PTS: 1

22. Management can expect various benefits to follow from implementing a system of strong internal control. Which of the following benefits is least likely to occur?
    a. reduced cost of an external audit.
    b. prevents employee collusion to commit fraud.
    c. availability of reliable data for decision-making purposes.
    d. some assurance of compliance with the Foreign Corrupt Practices Act of 1977.
    e. some assurance that important documents and records are protected.

    ANS: B PTS: 1

23. Which of the following situations is not a segregation of duties violation?
    a. The treasurer has the authority to sign checks but gives the signature block to the assistant treasurer to run the check-signing machine.
    b. The warehouse clerk, who has the custodial responsibility over inventory in the warehouse, selects the vendor and authorizes purchases when inventories are low.
    c. The sales manager has the responsibility to approve credit and the authority to write off accounts.
    d. The department time clerk is given the undistributed payroll checks to mail to absent employees.
    e. The accounting clerk who shares the record keeping responsibility for the accounts receivable subsidiary ledger performs the monthly reconciliation of the subsidiary ledger and the control account.

    ANS: B PTS: 1

24. Which concept is not an integral part of an audit?
    a. evaluating internal controls
    b. preparing financial statements
    c. expressing an opinion
    d. analyzing financial data

    ANS: B PTS: 1

25. Which statement is not true?
    a. Auditors must maintain independence.
    b. IT auditors attest to the integrity of the computer system.
    c. IT auditing is independent of the general financial audit.
    d. IT auditing can be performed by both external and internal auditors.

    ANS: C PTS: 1

26. Typically, internal auditors perform all of the following tasks except
    a. IT audits
    b. evaluation of operational efficiency
    c. review of compliance with legal obligations
    d. internal auditors perform all of the above tasks

    ANS: D PTS: 1

27. The fundamental difference between internal and external auditing is that
    a. internal auditors represent the interests of the organization and external auditors represent outsiders
    b. internal auditors perform IT audits and external auditors perform financial statement audits
    c. internal auditors focus on financial statement audits and external auditors focus on operational audits and financial statement audits
    d. external auditors assist internal auditors but internal auditors cannot assist external auditors

    ANS: A PTS: 1

28. Internal auditors assist external auditors with financial audits to
    a. reduce audit fees
    b. ensure independence
    c. represent the interests of management
    d. the statement is not true; internal auditors are not permitted to assist external auditors with financial audits

    ANS: A PTS: 1

29. Which statement is not correct?
    a. Auditors gather evidence using tests of controls and substantive tests.
    b. The most important element in determining the level of materiality is the mathematical formula.
    c. Auditors express an opinion in their audit report.
    d. Auditors compare evidence to established criteria.

    ANS: B PTS: 1

30. All of the following are steps in an IT audit except
    a. substantive testing
    b. tests of controls
    c. post-audit testing
    d. audit planning

    ANS: C PTS: 1

31. When planning the audit, information is gathered by all of the following methods except
    a. completing questionnaires
    b. interviewing management
    c. observing activities
    d. confirming accounts receivable

    ANS: D PTS: 1

32. Substantive tests include
    a. examining the safety deposit box for stock certificates
    b. reviewing systems documentation
    c. completing questionnaires
    d. observation

    ANS: A PTS: 1

33. Tests of controls include
    a. confirming accounts receivable
    b. counting inventory
    c. completing questionnaires
    d. counting cash

    ANS: C PTS: 1

34. All of the following are components of audit risk except
    a. control risk
    b. legal risk
    c. detection risk
    d. inherent risk

    ANS: B PTS: 1

35. Control risk is
    a. the probability that the auditor will render an unqualified opinion on financial statements that are materially misstated
    b. associated with the unique characteristics of the business or industry of the client
    c. the likelihood that the control structure is flawed because controls are either absent or inadequate to prevent or detect errors in the accounts
    d. the risk that auditors are willing to take that errors not detected or prevented by the control structure will also not be detected by the auditor

    ANS: C PTS: 1

36. Which of the following is true?
    a. In the CBIS environment, auditors gather evidence relating only to the contents of databases, not the reliability of the computer system.
    b. Conducting an audit is a systematic and logical process that applies to all forms of information systems.
    c. Substantive tests establish whether internal controls are functioning properly.
    d. IT auditors prepare the audit report if the system is computerized.

    ANS: B PTS: 1

37. Inherent risk
    a. exists because all control structures are flawed in some ways.
    b. is the likelihood that material misstatements exist in the financial statements of the firm.
    c. is associated with the unique characteristics of the business or industry of the client.
    d. is the likelihood that the auditor will not find material misstatements.

    ANS: C PTS: 1

38. Attestation services require all of the following except
    a. written assertions and a practitioner's written report
    b. the engagement is designed to conduct risk assessment of the client's systems to verify their degree of SOX compliance
    c. the formal establishment of measurements criteria
    d. the engagement is limited to examination, review, and application of agreed-upon procedures

    ANS: B PTS: 1

39. The financial statements of an organization reflect a set of management assertions about the financial health of the business. All of the following describe types of assertions except
    a. that all of the assets and equities on the balance sheet exist
    b. that all employees are properly trained to carry out their assigned duties
    c. that all transactions on the income statement actually occurred
    d. that all allocated amounts such as depreciation are calculated on a systematic and rational basis

    ANS: B PTS: 1

40. Which of the following is NOT an implication of section 302 of the Sarbanes-Oxley Act?
    a. Auditors must determine, whether changes in internal control has, or is likely to, materially affect internal control over financial reporting.
    b. Auditors must interview management regarding significant changes in the design or operation of internal control that occurred since the last audit.
    c. Corporate management (including the CEO) must certify monthly and annually their organization's internal controls over financial reporting.
    d. Management must disclose any material changes in the company's internal controls that have occurred during the most recent fiscal quarter.

    ANS: C PTS: 1

SHORT ANSWER

1. List the four broad objectives of the internal control system.

   ANS:
   safeguard assets,
   ensure the accuracy and reliability of accounting records,
   promote organizational efficiency,
   comply with management's policies and procedures

   PTS: 1

2. Explain the purpose of the PCAOB

   ANS:
   The PCAOB is empowered to set auditing, quality control, and ethics standards; to inspect registered accounting firms; to conduct investigations; and to take disciplinary actions.

   PTS: 1

3. What are the five internal control components described in the COSO framework

   ANS:
   the control environment, risk assessment, information and communication, monitoring, and control activities

   PTS: 1

4. What are management responsibilities under section 302 and 404?

   ANS:
   Section 302 requires that corporate management (including the CEO) certify their organization's internal controls on a quarterly and annual basis. Section 404 requires the management of public companies to assess and formally report on the effectiveness of their organization's internal controls.

   PTS: 1

5. Indicate whether each procedure is a preventive or detective control.

a.	authorizing a credit sale	Preventive	Detective
b.	preparing a bank reconciliation	Preventive	Detective
c.	locking the warehouse	Preventive	Detective
d.	preparing a trial balance	Preventive	Detective
e.	counting inventory	Preventive	Detective

   ANS:
   A. preventive; B. detective; C. preventive; D. detective; E. detective

   PTS: 1

Use the internal control procedures listed below to complete statements 6 through 12.

segregation of duties	specific authorization
general authorization	accounting records
access controls	independent verification
supervision	

6. A clerk reorders 250 items when the inventory falls below 25 items. This is an example of __________________________.

   ANS:
   general authorization

   PTS: 1

7. The internal audit department recalculates payroll for several employees each pay period. This is an example of __________________________.

   ANS:
   independent verification

   PTS: 1

8. Locking petty cash in a safe is an example of ___________________________.

   ANS:
   access controls

   PTS: 1

9. Approving a price reduction because goods are damaged is an example of ___________________________.

   ANS:
   specific authorization

   PTS: 1

10. Using cameras to monitor the activities of cashiers is an example of ___________________________.

    ANS:
    supervision

    PTS: 1

11. Not permitting the computer programmer to enter the computer room is an example of _________________________________.

    ANS:
    segregation of duties

    PTS: 1

12. Sequentially numbering all sales invoices is an example of ___________________________.

    ANS:
    accounting records

    PTS: 1

13. Both the SEC and the PCAOB have expressed an opinion as which internal control framework an organization should use to comply with SOX legislation. Explain.

    ANS:
    Both the SEC and PCAOB endorse the COSO framework but any framework can be used that encompasses all of the COSO's general themes

    PTS: 1

14. COSO identifies two broad groupings of information system controls. What are they?

    ANS:
    general; application

    PTS: 1

15. The Sarbanes-Oxley Act contains many sections. Which sections are the focus of this chapter?

    ANS:
    The chapter concentrates on internal control and audit responsibilities pursuant to Sections 302 and 404.

    PTS: 1

16. What are the objectives of application controls?

    ANS:
    The objectives of application controls are to ensure the validity, completeness, and accuracy financial transactions.

    PTS: 1

17. Define general controls.

    ANS:
    General controls apply to all systems. They are not application specific. General controls include controls over IT governance, the IT infrastructure, security and access to operating systems and databases, application acquisition and development, and program changes.

    PTS: 1

18. Discuss the key features of Section 302 of the Sarbanes-Oxley Act.

    ANS:
    Section 302 requires corporate management (including the chief executive officer [CEO]) to certify financial and other information contained in the organization's quarterly and annual reports. The rule also requires them to certify the internal controls over financial reporting. The certifying officers are required to have designed internal controls, or to have caused such controls to be designed, and to provide reasonable assurance as to the reliability of the financial reporting process. Furthermore, they must disclose any material changes in the company's internal controls that have occurred during the most recent fiscal quarter.

    PTS: 1

19. Explain the relationship between internal controls and substantive testing.

ANS:
The stronger the internal controls, the less substantive testing must be performed.

PTS: 1

20. Distinguish between errors and irregularities. Which do you think concern the auditors the most?

ANS:
Errors are unintentional mistakes; while irregularities are intentional misrepresentations to perpetrate a fraud or mislead the users of financial statements. Errors are a concern if they are numerous or sizable enough to cause the financial statements to be materially misstated. Processes which involve human actions will contain some amount of human error. Computer processes should only contain errors if the programs are erroneous, or if systems operating procedures are not being closely and competently followed. Errors are typically much easier to uncover than misrepresentations, thus auditors typically are more concerned whether they have uncovered any and all irregularities.

PTS: 1

21. Distinguish between inherent risk and control risk. How do internal controls and detection risk fit in?

ANS:
Inherent risk is associated with the unique characteristics of the business or industry of the client. Firms in declining industries are considered to have more inherent risk than firms in stable or thriving industries. Control risk is the likelihood that the control structure is flawed because internal controls are either absent or inadequate to prevent or detect errors in the accounts. Internal controls may be present in firms with inherent risk, yet the financial statements may be materially misstated due to circumstances outside the control of the firm, such as a customer with unpaid bills on the verge of bankruptcy. Detection risk is the risk that auditors are willing to accept that errors are not detected or prevented by the control structure. Typically, detection risk will be lower for firms with higher inherent risk and control risk.

PTS: 1

22. Contrast internal and external auditing.

ANS:
Internal auditing is an independent appraisal function established within an organization to examine and evaluate its activities as a service to the organization. External auditing is often called "independent auditing" because it is done by certified public accountants who are independent of the organization being audited. This independence is necessary since the external auditors represent the interests of third-party stakeholders such as shareholders, creditors, and government agencies.

PTS: 1

23. What are the components of audit risk?

ANS:
Inherent risk is associated with the unique characteristics of the business itself; control risk is the likelihood that the control structure is flawed because controls are absent or inadequate; and detection risk is the risk that auditors are willing to take that errors will not be detected by the audit.

PTS: 1

24. How do the tests of controls affect substantive tests?

ANS:
Tests of controls are used by the auditor to measure the strength of the internal control structure. The stronger the internal controls, the lower the control risk, and the less substantive testing the auditor must do.

PTS: 1

25. Define and contrast attestation services and advisory services.

ANS:
Attest services are engagements in which a practitioner is engaged to issue, or does issue, a written communication that expresses a conclusion about the reliability of a written assertion that is the responsibility of another party, e.g., the financial statements prepared by an organization.

Advisory services are professional services that are designed to improve the quality of information, both financial and non-financial, used by decision makers. The domain of assurance services is intentionally unbounded.

PTS: 1

ESSAY

1. What are the key points of the section 404 of the Sarbanes-Oxley Act?

ANS:
Section 404 requires the management of public companies to assess the effectiveness of their organization's internal controls. This entails providing an annual report addressing the following points: (1) a statement of management's responsibility for establishing and maintaining adequate internal control; (2) an assessment of the effectiveness of the company's internal controls over financial reporting; (3) a statement that the organization's external auditors have issued an attestation report on management's assessment of the company's internal controls; (4) an explicit written conclusion as to the effectiveness of internal control over financial reporting[1];<ftn> and (5) a statement identifying the framework used in their assessment of internal controls.

PTS: 1

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2. Section 404 requires management to make a statement identifying the control framework used to conduct their assessment of internal controls. Discuss the options in selecting a control framework.

   ANS:
   The SEC has made specific reference to the Committee of the Sponsoring Organizations of the Treadway Commission (COSO) as a recommended control framework. Furthermore, the PCAOB's Auditing Standard No. 2 endorses the use of COSO as the framework for control assessment. Although other suitable frameworks have been published, according to Standard No. 2, any framework used should encompass all of COSO's general themes.

   PTS: 1

3. Explain how general controls impact transaction integrity and the financial reporting process.

   ANS:
   Consider an organization with poor database security controls. In such a situation, even data processed by systems with adequate built in application controls may be at risk. An individual who can circumvent database security, may then change, steal, or corrupt stored transaction data. Thus, general controls are needed to support the functioning of application controls, and both are needed to ensure accurate financial reporting.

   PTS: 1

4. Prior to SOX, external auditors were required to be familiar with the client organization's internal controls, but not test them. Explain.

   ANS:
   Auditors had the option of not relying on internal controls in the conduct of an audit and therefore did not need to test them. Instead auditors could focus primarily of substantive tests. Under SOX, management is required to make specific assertions regarding the effectiveness of internal controls. To attest to the validity of these assertions, auditors are required to test the controls.
   PTS: 1

5. Does a qualified opinion on management's assessment of internal controls over the financial reporting system necessitate a qualified opinion on the financial statements? Explain.

   ANS:
   No. Auditors are permitted to simultaneously render a qualified opinion on management's assessment of internal controls and an unqualified opinion on the financial statements. In other words, it is technically possible for auditors to find internal controls over financial reporting to be weak, but conclude through substantive tests that the weaknesses did not cause the financial statements to be materially misrepresented.

   PTS: 1

6. The PCAOB's standard No. 2 specifically requires auditors to understand transaction flows in designing their test of controls. What steps does this entail?

   ANS:
   This involves:
   1. Selecting the financial accounts that have material implications for financial reporting. 2. Identify the application controls related to those accounts. 3. Identify the general that support the application controls.

   The sum of these controls, both application and general, constitute the relevant internal controls over financial reporting that need to be reviewed.

   PTS: 1

7. The text describes six internal control activities. List four of them and provide a specific example of each one.

   ANS:

Control Activity	**Example**
Authorization	general (purchase of inventory when level drops) or specific (credit approval beyond normal limit)
Segregation of functions	separate authorization from processing separate custody of assets from record keeping
Supervision	required when separation of duties is not possible, such as opening the mail (cash receipts)
Accounting records	maintain an adequate audit trail
Access controls	maintain physical security
Independent verification	bank reconciliation, physical inventory count

   PTS: 1

8. Explain the purpose of the PCAOB.

   ANS:
   The Sarbanes-Oxley Act creates a **Public Company Accounting Oversight Board (PCAOB)**. The PCAOB is empowered to set auditing, quality control, and ethics standards, to inspect registered accounting firms, to conduct investigations, and to take disciplinary actions.

   PTS: 1

9. Why is an Independent Audit Committee important to a company?

   ANS:
   The Sarbanes-Oxley Act requires all audit committee members to be independent and requires the audit committee to hire and oversee the external auditors. This provision is consistent with many investors who consider the board composition to be a critical investment factor. For example, Thompson Financial survey revealed that most institutional investors want corporate boards to be comprised of at least 75% of independent directors

PTS: 1

10. What are the key points of the "Issuer and Management Disclosure" of the Sarbanes-Oxley Act?

ANS:
1. Public companies must report all off balance-sheet transactions.
2. Annual reports filed with the SEC must include a statement by management asserting that it is responsible for creating and maintaining adequate internal controls and asserting to the effectiveness of those controls.
3. Officers must certify that the company's accounts 'fairly present' the firms financial condition and results of operations.
4. Knowingly filing a false certification is a criminal offence.

PTS: 1

11. In this age of high technology and computer based information systems, why are accountants concerned about *physical* (human) controls?

ANS:
Virtually all systems, regardless of their sophistication, employ human activities that need to be controlled. This class of controls relates primarily to the human activities employed in accounting systems. These activities may be purely manual, such as the physical custody of assets, or they may involve the use of computers to record transactions or update accounts. Physical controls do not relate to the computer logic that actually performs these accounting tasks. Rather, they relate to the human activities that initiate such computer logic. In other words, physical controls do not suggest an environment in which clerks update paper accounts with pen and ink.

PTS: 1

12. Discuss the advisory services that external auditors are no longer permitted to render to audit clients under SOX legislation.

ANS:
The Act addresses auditor independence by creating more separation between a firm's attestation and non-auditing activities. This is intended to specify categories of services that a public accounting firm cannot perform for its client. These include the following nine functions:
- Bookkeeping or other services related to the accounting records or financial statements;
- Financial information systems design and implementation;
- Appraisal or valuation services, fairness opinions, or contribution-in-kind reports;
- Actuarial services;
- Internal audit outsourcing services;
- Management functions or human resources;
- Broker or dealer, investment adviser, or investment banking services;
- Legal services and expert services unrelated to the audit; and
- Any other service that the PCAOB determines is impermissible.

While the Sarbanes-Oxley Act prohibits auditors from providing the above services to their audit clients, they are not prohibited from performing such services for non-audit clients or privately held companies.

PTS: 1

13. Internal control in a computerized environment can be divided into two broad categories. What are they? Explain each.

ANS:
Internal controls can be divided into two broad categories. *General controls* apply to all or most of a system to minimize exposures that threaten the integrity of the applications being processed. These include operating system controls, data management controls, organizational structure controls, system development controls, system maintenance controls, computer center security, Internet and Intranet controls, EDI controls, and PC controls. *Application controls* focus on exposures related to specific parts of the system: payroll, accounts receivable, etc.

PTS: 1

14. Define the management assertions of: existence or occurrence, completeness, rights and obligations, valuation or allocation, presentation and disclosure.

ANS:
The ***existence or occurrence*** assertion affirms that all assets and equities contained in the balance sheet exist and that all transactions in the income statement actually occurred**.**

The ***completeness*** assertion declares that no material assets, equities, or transactions have been omitted from the financial statements.
The ***rights and obligations*** assertion maintains that assets appearing on the balance sheet are owned by the entity and that the liabilities reported are obligations.

The ***valuation or allocation*** assertion states that assets and equities are valued in accordance with generally accepted accounting principles and that allocated amounts such as depreciation expense are calculated on a systematic and rational basis.

The ***presentation and disclosure*** assertion alleges that financial statement items are correctly classified (e.g.; long term liabilities will not mature within one year) and that footnote disclosures are adequate to avoid misleading the users of financial statements.

PTS: 1