**AUDITING**

**MILLICHAMP & TAYLOR**

**PRACTICE EXAM – CHAPTERS 1-10**

**ANSWERS**

*Note: Some of these answers are indicative rather than prescriptive and lecturers should use their own resources to aid student learning*

**1. Which of these statements is true?**

**An audit benefits a company because**

1. **It reassures the shareholders that the accounts are accurate**
2. **Makes the management accountable to the shareholders**
3. **Guarantees that the accounts are free from fraud or error**
4. **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 share-holder’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 500words 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