

ACC 435: Module 1: Review Questions Set 1

Define auditing- **(the act of conducting an official examination of an individual's or organization's accounts)**

Discuss why there is a demand for auditing services in the free market economy- **(There is a demand for auditing in a free-market economy because the agency relationship between an absentee owner and a manager produces a natural conflict of interest due to the information asymmetry that exists between the owner and manager. As a result, the agent agrees to be monitored as part of his/her employment contract. Auditing appears to be a cost-effective form of monitoring. The empirical evidence suggests auditing was demanded prior to government regulation. In 1926, before it was required by law, independent auditors audited 82 percent of the companies on the New York Stock Exchange.)**

Define attestation and assurance- **(Attest services occur when a practitioner issues a report on subject matter, or an assertion about subject matter, that is the responsibility of another party. Assurance services are independent professional services that improve the quality of information, or its context, for decision makers.)**

Describe why auditors must often exercise creativity and innovation in auditing financial statements- **(Auditors frequently face situations where no standard audit procedure exists, such as the example from the text of verifying the inventory of cattle. Such circumstances require that the auditor exercise creativity and innovation when planning and administering audit procedures where little or no guidance or precedent exists. Every client is different and applying auditing concepts in different situations requires logic and common sense, and frequently creativity and innovation.)**

Why is studying auditing different from studying other accounting topics- **(The study of auditing is more conceptual in nature compared to other accounting courses. Rather than focusing on learning the rules, techniques, and computations required to prepare financial statements, auditing emphasizes learning a framework of analytical and logical skills to evaluate the relevance and reliability of the systems and processes responsible for financial information, as well as the information itself. To be successful, students must learn the framework and then learn to use logic and common sense in applying auditing concepts to various circumstances and situations. Understanding auditing can improve the decision-making ability of consultants, business managers, and accountants by providing a framework for evaluating the usefulness and reliability of information—an important task in many different contexts.)**

Why is independence such an important requirement for auditors- **(Independence is an important auditing standard because the auditor adds justification and credibility to financial statement even when there are no material misstatements or omissions in the financial statements prepared by management)**

Define audit risk- **(Audit risk is defined as the risk that the auditor may unknowingly fail to appropriately modify his or her opinion on financial statements that are materially misstated.)**

Define materiality- **(Materiality is defined as "the magnitude of an omission or misstatement of accounting information that, in the light of surrounding circumstances, makes it probable that the**

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judgment of a reasonable person relying on the information would have been changed or influenced by the omission or misstatement")

What evidence suggests that auditing would be demanded even if it were not required by government regulation? - **(The empirical evidence suggests auditing was demanded prior to government regulation. In 1926, before it was required by law, independent auditors audited 82 percent of the companies on the New York Stock Exchange. Additionally, many private companies and municipalities not subject to government regulations, such as the Securities Act of 1933 and Securities Exchange Act of 1934, also purchase various forms of auditing and assurance services.)**