Auditing and Assurance Services A Systematic Approach 10th edition Messier Test Bank

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Chapter 02

The Financial Statement Auditing Environment

True / False Questions

1. A series of business and related auditing failures led to the passage of the Sarbanes-Oxley Act (2002).

   True False

2. The primary audit context with which an auditor is concerned is the auditee's industry or business.

   True False

3. The audit committee generally includes senior executives of the organization.

   True False

4. A financial statement audit is generally organized based on the five basic business processes or cycles.

   True False

5. One of the five basic business processes is the warehousing cycle.

   True False

6. The IAASB and the ASB collaborated on a replacement for the 10 GAAS standards which include principles underlying an audit conducted in accordance with generally accepted auditing standards.

   True False

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7. PCAOB auditing standards must be followed on all financial statement audits performed in the U.S.

   True False

8. A financial statement audit must be conducted based on GAAP.

   True False

9. Generally, the financial statements of U.S. companies must be prepared based on GAAP.

   True False

10. PCAOB auditing standards must be followed on all audits of public companies' financial statements.

    True False

Multiple Choice Questions

11. The Audit Committee consists of

    A. Members of management.
    B. A subcommittee of the AICPA who establish the SAS.
    C. Members of the Board of Directors.
    D. Appointed government overseers.

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12. What organization is responsible for setting auditing standards for audits of publicly-traded companies in the U.S.?

A. AICPA.
B. FASB.
C. GASB.
D. PCAOB.

13. The Public Company Accounting Oversight Board's role is to

A. Conduct the final review of auditors' work before the auditor's opinion is issued.
B. Oversee the auditors of public companies in order to protect the interests of investors.
C. Conduct audits of governmental entities.
D. Sanction auditors who fail to follow GAAS.

14. The authoritative body designed to promulgate standards concerning a CPA's association with audited financial statements of an entity that is required to file financial statements with the SEC is the

A. Financial Accounting Standards Board.
B. General Accounting Office.
C. Public Company Accounting Oversight Board.
D. Auditing Standards Board.

15. The auditor must be independent of the auditee unless

A. The lack of independence does not influence his or her professional judgment.
B. Both parties agree that the independence issue is not a problem.
C. The lack of independence is insignificant.
D. None of the above—the auditor cannot lack independence.

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16. Which of the following describes the PCAOB generally accepted auditing standard requiring a critical review of the work done and the judgment exercised by those assisting in an audit at every level of supervision?

A. Proficiency.
B. Audit risk.
C. Inspection.
D. Due care.

17. Which of the following best describes the general character of the three PCAOB generally accepted auditing standards that are classified as standards of fieldwork?

A. The competence, independence, and professional care of persons performing the audit.
B. Criteria for the content of the auditor's report on financial statements and related footnote disclosures.
C. The criteria of audit planning and evidence-gathering.
D. The need to maintain independence in mental attitude in all matters relating to the audit.

18. The first PCAOB general standard requires that the examination of financial statements is to be performed by a person or persons having adequate technical training and

A. Independence with respect to the financial statements and supplementary disclosures.
B. Exercising professional care as judged by peer reviewers.
C. Proficiency as an auditor, which likely has been acquired from previous experience.
D. Objectivity as an auditor as verified by proper supervision.

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19. The first PCAOB standard of reporting requires that, "the report shall state whether the financial statements are presented in accordance with generally accepted accounting principles." This passage requires

A. A statement of fact by the auditor.
B. An opinion by the auditor.
C. An implied measure of fairness.
D. An objective measure of compliance.

20. Because of the risk of material misstatement, an audit of financial statements in accordance with generally accepted auditing standards should be planned and performed with an attitude of

A. Objective cynicism.
B. Independent differentialism.
C. Professional skepticism.
D. Impartial conservatism.

21. The accuracy of information included in footnotes accompanying the audited financial statements issued by a company whose shares are traded on a stock exchange is the primary responsibility of

A. The stock exchange officials.
B. The independent auditor.
C. The company's management.
D. The Securities and Exchange Commission.

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22. The primary responsibility for the adequacy of disclosures in the financial statements of a publicly held company rests with the

A. Partner assigned to the audit engagement.
B. Management of the company.
C. Auditor in charge of the fieldwork.
D. Securities and Exchange Commission.

23. The largest public accounting firms typically are structured as

A. Subchapter S corporations.
B. Professional corporations.
C. Limited liability partnerships.
D. Limited liability corporations.

24. Typically, an external auditor first gets supervisory experience at what level of authority?

A. Associate.
B. Senior.
C. Manager.
D. Partner.

25. An "in-charge" auditor typically holds the rank of

A. Associate.
B. Senior.
C. Manager.
D. Partner.

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26. Which of the following best describes the concept of risk assessment on which auditors can provide independent assurance?

A. The risk that financial statements are misstated because of fraud.
B. The risk that financial statements are misstated because of error or fraud.
C. Whether management has systems in place to evaluate and effectively manage the entity's business risks.
D. Developing client acceptance and continuance practices that minimize the likelihood of lawsuits against the auditor.

27. Forensic audits include all of the following except

A. Criminal investigations.
B. Manufacturers' assertions about product quality.
C. Employee fraud.
D. Management fraud.

28. A typical objective of an operational audit is for the auditor to

A. Determine whether the financial statements present fairly the entity's operations.
B. Evaluate the feasibility of attaining the entity's operational objectives.
C. Make recommendations for improving performance.
D. Report on the entity's relative success in attaining profit maximization.

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29. Governmental auditing often extends beyond examinations leading to the expression of an opinion on the fairness of financial presentation and includes audits of efficiency, effectiveness, and

A. Monetary stimulus.
B. Evaluation.
C. Accuracy.
D. Compliance.

30. External auditors are referred to as "external" because

A. They report to users outside of the audited entity.
B. They are paid by parties outside of the audited entity.
C. They are not employees of the entity being audited.
D. Their offices are not at the entity's place of business.

31. Which is not an attribute of an external auditor?

A. Independence.
B. Auditee advocacy.
C. Objectivity.
D. Concern for the public interest.

32. What is the general character of the work conducted in performing a forensic audit for a company?

A. Providing assurance that the financial statements are not materially misstated.
B. Detecting or deterring fraudulent activity.
C. Offering an opinion on the reliability of the specific assertions made by management.
D. Identifying the causes of an entity's financial difficulties.

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33. Which of the following is NOT a requirement of the Sarbanes-Oxley Act?

A. Audit firms cannot provide most types of nonaudit services to their public company auditees.
B. Audit firms are required to rotate audit partners off audit engagements every five years for public company audits.
C. Firms that audit public companies are subject to inspection by the PCAOB.
D. A certain number of hours, which is based on the size of the company being audited, must be spent on each audit engagement.

34. A CPA is most likely to refer to one or more of the three PCAOB general auditing standards in determining

A. The nature of the CPA's report qualification.
B. The scope of the CPA's auditing procedures.
C. Requirements for the review of the entity and its environment.
D. Whether the CPA should undertake an audit engagement.

35. Who bears ultimate responsibility for the financial statements?

A. Management of the organization, equally with the external auditor that audits the statements.
B. Management and the shareholders of the organization.
C. The external auditor that audits the statements.
D. Management of the organization.

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36. The three PCAOB general standards are concerned with

A. Adequate training and proficiency of the auditor, proper planning and supervision, and due professional care.
B. Adequate training and independence.
C. Due professional care.
D. Independence, adequate training and due professional care.

37. The first PCAOB general standard recognizes that regardless of how capable an individual may be in other fields, the individual cannot meet the requirements of the auditing standards without the proper

A. Business and finance courses.
B. Quality control and peer review.
C. Education and experience in auditing.
D. Supervision and review skills.

38. The main difference between SAS and AU is

A. They are the same except that SAS are organized chronologically and the AU are organized by topical area.
B. SAS are issued by the ASB and AU are issued by the PCAOB.
C. SAS are issued by the PCAOB and AU are issued by the ASB.
D. SAS define minimum standards of performance for auditors while AU define financial accounting principles that must be followed according to GAAP.

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39. The AICPA's Statements on Auditing Standards can be described as

A. Providing very specific guidance about the specific activities an auditor must perform on each engagement.
B. Similar to financial accounting standards in that they are developed by the government.
C. Defining the minimum standards of performance for an auditor.
D. Providing assurance that an auditor will not issue an incorrect opinion.

40. Due professional care requires auditors to

A. Obtain independent, third party (non-auditee) documentation as evidence for all information presented in the financial statements.
B. Exercise professional skepticism during the audit.
C. Disregard any evidence generated by the auditee during the audit.
D. Find every error contained in the financial statements prepared by management.

41. The objective of the second PCAOB Standard of Reporting is to provide assurance that

A. There are no variations in the format and presentation of financial statements.
B. Substantially different transactions and events are not accounted for on an identical basis.
C. The auditor is consulted before material changes are made in the application of accounting principles.
D. The comparability of financial statements between periods is not materially affected by changes in accounting principles that are not disclosed.

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42. An internal auditor is likely to be more concerned with _____ than the external auditor.

A. Internal administrative procedures
B. Cost accounting procedures
C. The efficiency of operations
D. Internal control

43. Which of the following is not included in the broad category of assurance services?

A. Operational audit.
B. Reporting on internal control.
C. Accounting or review services.
D. Evaluation of the auditee's risk management framework.

44. Which of the following is not explicitly a part of the IIA's definition of internal auditing?

A. Internal auditing is an objective assurance activity.
B. Internal auditing is a consulting activity.
C. Internal auditing should help an organization accomplish its objectives.
D. Internal auditors should help external auditors complete the annual financial statement audit.

45. Which of the following statements regarding the PCAOB is incorrect?

A. It is a public-sector, nonprofit corporation.
B. It is overseen by the SEC.
C. It sets standards for public company audits.
D. It has delegated all of its standard-setting authority to the AICPA.

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46. Due professional care requires

A. Auditors to plan and perform their duties with the skill and care that is commonly expected of accounting professionals.
B. The examination of all available corroborating evidence.
C. The exercise of error-free judgment.
D. A study and review of internal controls that includes tests of controls.

47. Which of the following best describes the role of corporate governance?

A. Management decides which accounting principles are the most appropriate.
B. Shareholders vote to decide who should be members of the board of directors.
C. Holding the management team accountable to shareholders and other constituents for the utilization of the entity's resources.
D. Management often is compensated based on the company's profitability.

48. The four PCAOB standards of reporting are concerned with all of the following except

A. The presentation of the financial statements based on GAAS.
B. The presentation of the financial statements based on GAAP.
C. Whether principles are consistently applied, whether all informative disclosures have been made, and the degree of responsibility the auditor is taking.
D. The degree of responsibility the auditor is taking.

49. Which of the following best describes what is meant by generally accepted auditing standards?

A. Audit assertions generally determined on audit engagements.
B. Acts to be performed by the auditor.
C. Standards of quality for the auditor's performance.
D. Procedures to be used to gather evidence to support financial statements.

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50. The fourth PCAOB standard of reporting requires an auditor to render a report whenever an auditor's name is associated with financial statements. The overall purpose of the fourth standard of reporting is to require that reports

A. State that the examination of financial statements has been conducted in accordance with generally accepted auditing standards.
B. Indicate the character of the auditor's examination and the degree of responsibility assumed by the auditor.
C. Imply that the auditor is independent in fact as well as in appearance with respect to the financial statements under examination.
D. Express whether the accounting principles used in preparing the financial statements have been applied consistently in the period under examination.

51. The three PCAOB standards of fieldwork are concerned with

A. Planning and supervision and understanding the auditee's internal control system.
B. Choosing evidence with due professional care.
C. Adequate training to understand the auditee's internal controls system.
D. Ensuring consistency in financial statements for periods presented.

52. The fourth PCAOB reporting standard requires the auditor's report to contain either an expression of opinion regarding the financial statements taken as a whole or an assertion to the effect that an opinion cannot be expressed. The objective of the fourth standard is to prevent

A. An auditor from reporting on one basic financial statement and not the others.
B. An auditor from expressing different opinions on each of the basic financial statements.
C. Management from reducing its final responsibility for the basic financial statements.
D. Misinterpretations regarding the degree of responsibility the auditor is assuming.

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Short Answer Questions

53. The IAASB and the ASB have collaborated on the principles underlying an audit conducted in accordance with generally accepted auditing standards. These principles are grouped into four categories. What are the four categories?

54. The principles underlying an audit conducted in accordance with generally accepted auditing standards are grouped into four categories. The second category is that of "personal responsibility of the auditor." Generally explain what is intended by this principle.

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55. You are the owner of a small grocery store, Corner Marketplace. Explain the five process categories and how they apply to your business.

56. Define corporate governance, the board of directors, and the audit committee and explain how they relate to each other.

57. Describe the organizations involved in standard setting for auditors in the United States and what their respective roles are in setting current auditing standards for companies in the United States.

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58. What are the three PCAOB general auditing standards found within the 10 GAAS (NOT the three main categories of GAAS) and why is each important?

59. Jane Goodperson performed an audit on the Quagmire Corporation and issued an unqualified opinion. Jane performed the audit with due professional care and in accordance with generally accepted auditing standards. Two months after the report is issued, Jane discovers on the news that the CEO of Quagmire, Johnny Best, had been stealing small amounts of inventory. The amount, however, is immaterial compared to the overall inventory of the corporation. Jane soon receives a call from Quagmire's CFO, Mark Beastly. Mark wants Jane to refund her audit fees. Mark thinks Jane did not properly perform the audit, as she did not discover this fraud. Further, he feels that now Quagmire's financial statements are not fairly stated because of Jane. How should Jane respond to this claim?

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60. Mike has just graduated from State University with a bachelor's degree in accounting. He would like to pursue a career in auditing. What options does Mike have? Describe three auditing career options, including a description of the organization Mike would work for.

61. With respect to an entity's financial statements, describe both the responsibility of management and that of the auditor.

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62. What auditing standards are used to conduct an audit for a privately-held corporation? What auditing standards are used to conduct an audit for a publicly-traded corporation? What organization is responsible for setting each of these sets of standards?

63. There are several types of audit services that are provided by auditors. Identify and define three of these types of audits.

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Chapter 02 The Financial Statement Auditing Environment Answer Key

True / False Questions

1. A series of business and related auditing failures led to the passage of the Sarbanes-Oxley Act (2002).

   TRUE

AACSB: Communication
AICPA: BB Legal
AICPA: FN Measurement
Accessibility: Keyboard Navigation
Blooms: Remember
Difficulty: 1 Easy
Learning Objective: 02-04 Understand the significant changes that have taken place in the auditing profession over the past decade.
Topic: A Decade of Challenge and Change for Financial Statement Auditors

2. The primary audit context with which an auditor is concerned is the auditee's industry or business.

   TRUE

AACSB: Communication
AICPA: BB Industry
AICPA: FN Decision Making
Accessibility: Keyboard Navigation
Blooms: Remember
Difficulty: 1 Easy
Learning Objective: 02-06 Recognize that an audit is shaped by the auditee's business; industry; and economic environment; and understand the essential components and processes characteristic of most business entities.
Topic: A Model of Business

3. The audit committee generally includes senior executives of the organization.

   FALSE

AACSB: Communication
AICPA: BB Industry

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AICPA: FN Reporting
Accessibility: Keyboard Navigation
Blooms: Remember
Difficulty: 1 Easy
Learning Objective: 02-06 Recognize that an audit is shaped by the auditee's business; industry; and economic environment; and understand the essential components and processes characteristic of most business entities.
Topic: A Model of Business

4. A financial statement audit is generally organized based on the five basic business processes or cycles.

TRUE

AACSB: Communication
AICPA: BB Industry
AICPA: FN Decision Making
Accessibility: Keyboard Navigation
Blooms: Remember
Difficulty: 1 Easy
Learning Objective: 02-07 Be familiar with a five-component model of business processes used to organize an audit.
Topic: A Model of Business

5. One of the five basic business processes is the warehousing cycle.

FALSE

AACSB: Communication
AICPA: BB Industry
AICPA: FN Decision Making
Accessibility: Keyboard Navigation
Blooms: Remember
Difficulty: 1 Easy
Learning Objective: 02-07 Be familiar with a five-component model of business processes used to organize an audit.
Topic: A Model of Business

6. The IAASB and the ASB collaborated on a replacement for the 10 GAAS standards which include principles underlying an audit conducted in accordance with generally accepted auditing standards.

TRUE

AACSB: Communication

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AICPA: BB Legal
AICPA: FN Reporting
Accessibility: Keyboard Navigation
Blooms: Remember
Difficulty: 1 Easy
Learning Objective: 02-09 Understand that auditing standards are established by both U.S. and international standard setters.
Learning Objective: 02-10 Be familiar with the 10 "generally accepted auditing standards" and the "principles underlying an audit conducted in accordance with generally accepted auditing standards."
Topic: Auditing Standards

7. PCAOB auditing standards must be followed on all financial statement audits performed in the U.S.

FALSE

AACSB: Communication
AICPA: BB Legal
AICPA: FN Reporting
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: 1 Easy
Learning Objective: 02-08 Identify and be familiar with the major organizations that affect the public accounting profession's environment.
Topic: A Model of Business

8. A financial statement audit must be conducted based on GAAP.

FALSE

AACSB: Communication
AICPA: BB Legal
AICPA: FN Reporting
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: 1 Easy
Learning Objective: 02-09 Understand that auditing standards are established by both U.S. and international standard setters.
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Topic: Auditing Standards

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9. Generally, the financial statements of U.S. companies must be prepared based on GAAP.

TRUE

AACSB: Communication
AICPA: BB Legal
AICPA: FN Reporting
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: 1 Easy
Learning Objective: 02-09 Understand that auditing standards are established by both U.S. and international standard setters.
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Topic: Auditing Standards

10. PCAOB auditing standards must be followed on all audits of public companies' financial statements.

TRUE

AACSB: Communication
AICPA: BB Legal
AICPA: FN Reporting
Accessibility: Keyboard Navigation
Blooms: Remember
Difficulty: 1 Easy
Learning Objective: 02-08 Identify and be familiar with the major organizations that affect the public accounting profession's environment.
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Multiple Choice Questions

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11. The Audit Committee consists of

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C. Members of the Board of Directors.
D. Appointed government overseers.

AACSB: Analytical Thinking
AICPA: BB Critical Thinking
AICPA: FN Measurement
Accessibility: Keyboard Navigation
Blooms: Remember
Difficulty: 1 Easy
Learning Objective: 02-06 Recognize that an audit is shaped by the auditee's business; industry; and economic environment; and understand the essential components and processes characteristic of most business entities.
Topic: A Model of Business

12. What organization is responsible for setting auditing standards for audits of publicly-traded companies in the U.S.?

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B. FASB.
C. GASB.
D. PCAOB.

AACSB: Communication
AICPA: BB Legal
AICPA: FN Reporting
Accessibility: Keyboard Navigation
Blooms: Remember
Difficulty: 1 Easy
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13. The Public Company Accounting Oversight Board's role is to

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B. Oversee the auditors of public companies in order to protect the interests of investors.
C. Conduct audits of governmental entities.
D. Sanction auditors who fail to follow GAAS.

AACSB: Communication
AICPA: BB Legal
AICPA: FN Reporting
Accessibility: Keyboard Navigation
Blooms: Remember
Difficulty: 1 Easy
Learning Objective: 02-08 Identify and be familiar with the major organizations that affect the public accounting profession's environment.
Topic: A Model of Business

14. The authoritative body designed to promulgate standards concerning a CPA's association with audited financial statements of an entity that is required to file financial statements with the SEC is the

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B. General Accounting Office.
C. Public Company Accounting Oversight Board.
D. Auditing Standards Board.

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AICPA: BB Legal
AICPA: FN Reporting
Accessibility: Keyboard Navigation
Blooms: Remember
Difficulty: 1 Easy
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15. The auditor must be independent of the auditee unless

A. The lack of independence does not influence his or her professional judgment.
B. Both parties agree that the independence issue is not a problem.
C. The lack of independence is insignificant.
D. None of the above—the auditor cannot lack independence.

AACSB: Analytical Thinking
AICPA: BB Legal
AICPA: FN Decision Making
Accessibility: Keyboard Navigation
Blooms: Apply
Difficulty: 2 Medium
Learning Objective: 02-09 Understand that auditing standards are established by both U.S. and international standard setters.
Learning Objective: 02-10 Be familiar with the 10 "generally accepted auditing standards" and the "principles underlying an audit conducted in accordance with generally accepted auditing standards."
Topic: Auditing Standards

16. Which of the following describes the PCAOB generally accepted auditing standard requiring a critical review of the work done and the judgment exercised by those assisting in an audit at every level of supervision?

A. Proficiency.
B. Audit risk.
C. Inspection.
D. Due care.

AACSB: Analytical Thinking
AICPA: BB Resource Management
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Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: 1 Easy
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A. The competence, independence, and professional care of persons performing the audit.
B. Criteria for the content of the auditor's report on financial statements and related footnote disclosures.
C. The criteria of audit planning and evidence-gathering.
D. The need to maintain independence in mental attitude in all matters relating to the audit.

AACSB: Analytical Thinking
AICPA: BB Legal
AICPA: FN Decision Making
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: 1 Easy
Learning Objective: 02-09 Understand that auditing standards are established by both U.S. and international standard setters.
Learning Objective: 02-10 Be familiar with the 10 "generally accepted auditing standards" and the "principles underlying an audit conducted in accordance with generally accepted auditing standards."
Learning Objective: 02-12 Understand that the auditing profession places a premium on ethical behavior and is governed by a Code of Professional Conduct.
Topic: Auditing Standards
Topic: Auditing, Ethics, and the Code of Professional Conduct

18. The first PCAOB general standard requires that the examination of financial statements is to be performed by a person or persons having adequate technical training and

A. Independence with respect to the financial statements and supplementary disclosures.
B. Exercising professional care as judged by peer reviewers.
C. Proficiency as an auditor, which likely has been acquired from previous experience.
D. Objectivity as an auditor as verified by proper supervision.

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Difficulty: 1 Easy
Learning Objective: 02-09 Understand that auditing standards are established by both U.S. and international standard setters.

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Learning Objective: 02-10 Be familiar with the 10 "generally accepted auditing standards" and the "principles underlying an audit conducted in accordance with generally accepted auditing standards."
Learning Objective: 02-12 Understand that the auditing profession places a premium on ethical behavior and is governed by a Code of Professional Conduct.
Topic: Auditing Standards
Topic: Auditing, Ethics, and the Code of Professional Conduct

19. The first PCAOB standard of reporting requires that, "the report shall state whether the financial statements are presented in accordance with generally accepted accounting principles." This passage requires

A. A statement of fact by the auditor.
B. An opinion by the auditor.
C. An implied measure of fairness.
D. An objective measure of compliance.

AACSB: Communication
AICPA: BB Legal
AICPA: FN Reporting
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: 1 Easy
Learning Objective: 02-09 Understand that auditing standards are established by both U.S. and international standard setters.
Learning Objective: 02-10 Be familiar with the 10 "generally accepted auditing standards" and the "principles underlying an audit conducted in accordance with generally accepted auditing standards."
Topic: Auditing Standards

20. Because of the risk of material misstatement, an audit of financial statements in accordance with generally accepted auditing standards should be planned and performed with an attitude of

A. Objective cynicism.
B. Independent differentialism.
C. Professional skepticism.
D. Impartial conservatism.

AACSB: Analytical Thinking
AICPA: BB Legal
AICPA: FN Risk Analysis

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Accessibility: Keyboard Navigation
Blooms: Apply
Difficulty: 2 Medium
Learning Objective: 02-05 Know that management is primarily responsible for the entity's financial statements and understand the auditor's responsibility for detecting errors; material fraud; and illegal acts.
Learning Objective: 02-12 Understand that the auditing profession places a premium on ethical behavior and is governed by a Code of Professional Conduct.
Topic: Auditing, Ethics, and the Code of Professional Conduct
Topic: Society's Expectations and the Auditor's Responsibilities

21. The accuracy of information included in footnotes accompanying the audited financial statements issued by a company whose shares are traded on a stock exchange is the primary responsibility of

A. The stock exchange officials.
B. The independent auditor.
C. The company's management.
D. The Securities and Exchange Commission.

AACSB: Communication
AICPA: BB Legal
AICPA: FN Reporting
Accessibility: Keyboard Navigation
Blooms: Remember
Difficulty: 1 Easy
Learning Objective: 02-05 Know that management is primarily responsible for the entity's financial statements and understand the auditor's responsibility for detecting errors; material fraud; and illegal acts.
Topic: Society's Expectations and the Auditor's Responsibilities

22. The primary responsibility for the adequacy of disclosures in the financial statements of a publicly held company rests with the

A. Partner assigned to the audit engagement.
B. Management of the company.
C. Auditor in charge of the fieldwork.
D. Securities and Exchange Commission.

AACSB: Communication

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AICPA: BB Legal
AICPA: FN Reporting
Accessibility: Keyboard Navigation
Blooms: Remember
Difficulty: 1 Easy
Learning Objective: 02-05 Know that management is primarily responsible for the entity's financial statements and understand the auditor's responsibility for detecting errors; material fraud; and illegal acts.
Topic: Society's Expectations and the Auditor's Responsibilities

23. The largest public accounting firms typically are structured as

A. Subchapter S corporations.
B. Professional corporations.
C. Limited liability partnerships.
D. Limited liability corporations.

AACSB: Communication
AICPA: BB Legal
AICPA: FN Research
Accessibility: Keyboard Navigation
Blooms: Remember
Difficulty: 1 Easy
Learning Objective: 02-03 Understand the organization of public accounting firms and the composition of audit teams.
Topic: Accounting Firms and Audit Teams

24. Typically, an external auditor first gets supervisory experience at what level of authority?

A. Associate.
B. Senior.
C. Manager.
D. Partner.

AACSB: Communication
AICPA: BB Resource Management
AICPA: FN Measurement
Accessibility: Keyboard Navigation
Blooms: Remember
Difficulty: 1 Easy
Learning Objective: 02-03 Understand the organization of public accounting firms and the composition of audit teams.

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Topic: Accounting Firms and Audit Teams

25. An "in-charge" auditor typically holds the rank of

A. Associate.
B. Senior.
C. Manager.
D. Partner.

AACSB: Communication
AICPA: BB Resource Management
AICPA: FN Measurement
Accessibility: Keyboard Navigation
Blooms: Remember
Difficulty: 1 Easy
Learning Objective: 02-03 Understand the organization of public accounting firms and the composition of audit teams.
Topic: Accounting Firms and Audit Teams

26. Which of the following best describes the concept of risk assessment on which auditors can provide independent assurance?

A. The risk that financial statements are misstated because of fraud.
B. The risk that financial statements are misstated because of error or fraud.
C. Whether management has systems in place to evaluate and effectively manage the entity's business risks.
D. Developing client acceptance and continuance practices that minimize the likelihood of lawsuits against the auditor.

AACSB: Analytical Thinking
AICPA: BB Critical Thinking
AICPA: FN Risk Analysis
Accessibility: Keyboard Navigation
Blooms: Apply
Difficulty: 1 Easy
Learning Objective: 02-02 Be familiar with the various types of audit; attest; and assurance services offered by accounting professionals.
Topic: Types of Other Audit, Attest, and Assurance Services

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27. Forensic audits include all of the following except

A. Criminal investigations.

B. Manufacturers' assertions about product quality.

C. Employee fraud.

D. Management fraud.

AACSB: Communication
AICPA: BB Industry
AICPA: FN Leveraging Technology
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: 1 Easy
Learning Objective: 02-02 Be familiar with the various types of audit; attest; and assurance services offered by accounting professionals.
Topic: Types of Other Audit, Attest, and Assurance Services

28. A typical objective of an operational audit is for the auditor to

A. Determine whether the financial statements present fairly the entity's operations.

B. Evaluate the feasibility of attaining the entity's operational objectives.

C. Make recommendations for improving performance.

D. Report on the entity's relative success in attaining profit maximization.

AACSB: Communication
AICPA: BB Industry
AICPA: FN Leveraging Technology
Accessibility: Keyboard Navigation
Blooms: Remember
Difficulty: 1 Easy
Learning Objective: 02-02 Be familiar with the various types of audit; attest; and assurance services offered by accounting professionals.
Topic: Types of Other Audit, Attest, and Assurance Services

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29. Governmental auditing often extends beyond examinations leading to the expression of an opinion on the fairness of financial presentation and includes audits of efficiency, effectiveness, and

A. Monetary stimulus.
B. Evaluation.
C. Accuracy.
D. Compliance.

AACSB: Communication
AICPA: BB Industry
AICPA: FN Leveraging Technology
Accessibility: Keyboard Navigation
Blooms: Remember
Difficulty: 1 Easy
Learning Objective: 02-02 Be familiar with the various types of audit; attest; and assurance services offered by accounting professionals.
Topic: Types of Other Audit, Attest, and Assurance Services

30. External auditors are referred to as "external" because

A. They report to users outside of the audited entity.
B. They are paid by parties outside of the audited entity.
C. They are not employees of the entity being audited.
D. Their offices are not at the entity's place of business.

AACSB: Communication
AICPA: BB Industry
AICPA: FN Decision Making
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: 1 Easy
Learning Objective: 02-01 Be familiar with the different types of auditors.
Topic: Types of Auditors

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31. Which is not an attribute of an external auditor?

A. Independence.

B. Auditee advocacy.

C. Objectivity.

D. Concern for the public interest.

AACSB: Communication
AICPA: BB Industry
AICPA: FN Decision Making
Accessibility: Keyboard Navigation
Blooms: Remember
Difficulty: 1 Easy
Learning Objective: 02-01 Be familiar with the different types of auditors.
Topic: Types of Auditors

32. What is the general character of the work conducted in performing a forensic audit for a company?

A. Providing assurance that the financial statements are not materially misstated.

B. Detecting or deterring fraudulent activity.

C. Offering an opinion on the reliability of the specific assertions made by management.

D. Identifying the causes of an entity's financial difficulties.

AACSB: Communication
AICPA: BB Industry
AICPA: FN Leveraging Technology
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: 1 Easy
Learning Objective: 02-02 Be familiar with the various types of audit; attest; and assurance services offered by accounting professionals.
Topic: Types of Other Audit, Attest, and Assurance Services

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33. Which of the following is NOT a requirement of the Sarbanes-Oxley Act?

A. Audit firms cannot provide most types of nonaudit services to their public company auditees.
B. Audit firms are required to rotate audit partners off audit engagements every five years for public company audits.
C. Firms that audit public companies are subject to inspection by the PCAOB.
D. A certain number of hours, which is based on the size of the company being audited, must be spent on each audit engagement.

AACSB: Communication
AICPA: BB Legal
AICPA: FN Reporting
Accessibility: Keyboard Navigation
Blooms: Remember
Difficulty: 2 Medium
Learning Objective: 02-04 Understand the significant changes that have taken place in the auditing profession over the past decade.
Learning Objective: 02-08 Identify and be familiar with the major organizations that affect the public accounting profession's environment.
Topic: A Decade of Challenge and Change for Financial Statement Auditors
Topic: A Model of Business

34. A CPA is most likely to refer to one or more of the three PCAOB general auditing standards in determining

A. The nature of the CPA's report qualification.
B. The scope of the CPA's auditing procedures.
C. Requirements for the review of the entity and its environment.
D. Whether the CPA should undertake an audit engagement.

AACSB: Communication
AICPA: BB Legal
AICPA: FN Decision Making
Accessibility: Keyboard Navigation
Blooms: Apply
Difficulty: 2 Medium
Learning Objective: 02-06 Recognize that an audit is shaped by the auditee's business; industry; and economic environment; and understand the essential components and processes characteristic of most business entities.
Learning Objective: 02-09 Understand that auditing standards are established by both U.S. and international standard setters.

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Learning Objective: 02-10 Be familiar with the 10 "generally accepted auditing standards" and the "principles underlying an audit conducted in accordance with generally accepted auditing standards."
Topic: A Model of Business
Topic: Auditing Standards

35. Who bears ultimate responsibility for the financial statements?

A. Management of the organization, equally with the external auditor that audits the statements.
B. Management and the shareholders of the organization.
C. The external auditor that audits the statements.
D. Management of the organization.

AACSB: Analytical Thinking
AICPA: BB Legal
AICPA: FN Measurement
Accessibility: Keyboard Navigation
Blooms: Remember
Difficulty: 1 Easy
Learning Objective: 02-05 Know that management is primarily responsible for the entity's financial statements and understand the auditor's responsibility for detecting errors; material fraud; and illegal acts.
Topic: Society's Expectations and the Auditor's Responsibilities

36. The three PCAOB general standards are concerned with

A. Adequate training and proficiency of the auditor, proper planning and supervision, and due professional care.
B. Adequate training and independence.
C. Due professional care.
D. Independence, adequate training and due professional care.

AACSB: Communication
AICPA: BB Legal
AICPA: FN Measurement
Accessibility: Keyboard Navigation
Blooms: Remember
Difficulty: 2 Medium
Learning Objective: 02-09 Understand that auditing standards are established by both U.S. and international standard setters.
Learning Objective: 02-10 Be familiar with the 10 "generally accepted auditing standards" and the "principles underlying an audit conducted in accordance with generally accepted auditing standards."

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Topic: Auditing Standards

37. The first PCAOB general standard recognizes that regardless of how capable an individual may be in other fields, the individual cannot meet the requirements of the auditing standards without the proper

A. Business and finance courses.
B. Quality control and peer review.
C. Education and experience in auditing.
D. Supervision and review skills.

AACSB: Diversity
AICPA: BB Marketing
AICPA: FN Decision Making
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: 2 Medium
Learning Objective: 02-09 Understand that auditing standards are established by both U.S. and international standard setters.
Learning Objective: 02-10 Be familiar with the 10 "generally accepted auditing standards" and the "principles underlying an audit conducted in accordance with generally accepted auditing standards."
Topic: Auditing Standards

38. The main difference between SAS and AU is

A. They are the same except that SAS are organized chronologically and the AU are organized by topical area.
B. SAS are issued by the ASB and AU are issued by the PCAOB.
C. SAS are issued by the PCAOB and AU are issued by the ASB.
D. SAS define minimum standards of performance for auditors while AU define financial accounting principles that must be followed according to GAAP.

AACSB: Communication
AICPA: BB Resource Management
AICPA: FN Decision Making
Accessibility: Keyboard Navigation
Blooms: Analyze
Difficulty: 2 Medium
Learning Objective: 02-11 Understand the nature of auditing standards.

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Topic: Auditing Standards

39. The AICPA's Statements on Auditing Standards can be described as

A. Providing very specific guidance about the specific activities an auditor must perform on each engagement.
B. Similar to financial accounting standards in that they are developed by the government.
C. Defining the minimum standards of performance for an auditor.
D. Providing assurance that an auditor will not issue an incorrect opinion.

AACSB: Communication
AICPA: BB Legal
AICPA: FN Measurement
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: 2 Medium
Learning Objective: 02-11 Understand the nature of auditing standards.
Topic: Auditing Standards

40. Due professional care requires auditors to

A. Obtain independent, third party (non-auditee) documentation as evidence for all information presented in the financial statements.
B. Exercise professional skepticism during the audit.
C. Disregard any evidence generated by the auditee during the audit.
D. Find every error contained in the financial statements prepared by management.

AACSB: Communication
AICPA: BB Legal
AICPA: FN Decision Making
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: 2 Medium
Learning Objective: 02-05 Know that management is primarily responsible for the entity's financial statements and understand the auditor's responsibility for detecting errors; material fraud; and illegal acts.
Topic: Society's Expectations and the Auditor's Responsibilities

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41. The objective of the second PCAOB Standard of Reporting is to provide assurance that

A. There are no variations in the format and presentation of financial statements.
B. Substantially different transactions and events are not accounted for on an identical basis.
C. The auditor is consulted before material changes are made in the application of accounting principles.
D. The comparability of financial statements between periods is not materially affected by changes in accounting principles that are not disclosed.

AACSB: Analytical Thinking
AICPA: BB Legal
AICPA: FN Measurement
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: 2 Medium
Learning Objective: 02-09 Understand that auditing standards are established by both U.S. and international standard setters.
Learning Objective: 02-10 Be familiar with the 10 "generally accepted auditing standards" and the "principles underlying an audit conducted in accordance with generally accepted auditing standards."
Topic: Auditing Standards

42. An internal auditor is likely to be more concerned with _____ than the external auditor.

A. Internal administrative procedures
B. Cost accounting procedures
C. The efficiency of operations
D. Internal control

AACSB: Analytical Thinking
AICPA: BB Industry
AICPA: FN Risk Analysis
Accessibility: Keyboard Navigation
Blooms: Apply
Difficulty: 2 Medium
Learning Objective: 02-01 Be familiar with the different types of auditors.
Learning Objective: 02-02 Be familiar with the various types of audit; attest; and assurance services offered by accounting professionals.
Topic: Types of Auditors

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Topic: Types of Other Audit, Attest, and Assurance Services

43. Which of the following is not included in the broad category of assurance services?

A. Operational audit.
B. Reporting on internal control.
C. Accounting or review services.
D. Evaluation of the auditee's risk management framework.

AACSB: Communication
AICPA: BB Industry
AICPA: FN Reporting
Accessibility: Keyboard Navigation
Blooms: Apply
Difficulty: 2 Medium
Learning Objective: 02-02 Be familiar with the various types of audit; attest; and assurance services offered by accounting professionals.
Topic: Types of Other Audit, Attest, and Assurance Services

44. Which of the following is not explicitly a part of the IIA's definition of internal auditing?

A. Internal auditing is an objective assurance activity.
B. Internal auditing is a consulting activity.
C. Internal auditing should help an organization accomplish its objectives.
D. Internal auditors should help external auditors complete the annual financial statement audit.

AACSB: Communication
AICPA: BB Industry
AICPA: FN Research
Accessibility: Keyboard Navigation
Blooms: Remember
Difficulty: 1 Easy
Learning Objective: 02-01 Be familiar with the different types of auditors.
Topic: Types of Auditors

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45. Which of the following statements regarding the PCAOB is incorrect?

A. It is a public-sector, nonprofit corporation.
B. It is overseen by the SEC.
C. It sets standards for public company audits.
D. It has delegated all of its standard-setting authority to the AICPA.

AACSB: Communication
AICPA: BB Legal
AICPA: FN Decision Making
Accessibility: Keyboard Navigation
Blooms: Remember
Difficulty: 2 Medium
Learning Objective: 02-08 Identify and be familiar with the major organizations that affect the public accounting profession's environment.
Topic: A Model of Business

46. Due professional care requires

A. Auditors to plan and perform their duties with the skill and care that is commonly expected of accounting professionals.
B. The examination of all available corroborating evidence.
C. The exercise of error-free judgment.
D. A study and review of internal controls that includes tests of controls.

AACSB: Ethics
AICPA: BB Critical Thinking
AICPA: FN Decision Making
Accessibility: Keyboard Navigation
Blooms: Remember
Difficulty: 1 Easy
Learning Objective: 02-06 Recognize that an audit is shaped by the auditee's business; industry; and economic environment; and understand the essential components and processes characteristic of most business entities.
Learning Objective: 02-09 Understand that auditing standards are established by both U.S. and international standard setters.
Learning Objective: 02-10 Be familiar with the 10 "generally accepted auditing standards" and the "principles underlying an audit conducted in accordance with generally accepted auditing standards."
Topic: A Model of Business
Topic: Auditing Standards

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47. Which of the following best describes the role of corporate governance?

A. Management decides which accounting principles are the most appropriate.
B. Shareholders vote to decide who should be members of the board of directors.
C. Holding the management team accountable to shareholders and other constituents for the utilization of the entity's resources.
D. Management often is compensated based on the company's profitability.

AACSB: Communication
AICPA: BB Industry
AICPA: FN Decision Making
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: 3 Hard
Learning Objective: 02-06 Recognize that an audit is shaped by the auditee's business; industry; and economic environment; and understand the essential components and processes characteristic of most business entities.
Topic: A Model of Business

48. The four PCAOB standards of reporting are concerned with all of the following except

A. The presentation of the financial statements based on GAAS.
B. The presentation of the financial statements based on GAAP.
C. Whether principles are consistently applied, whether all informative disclosures have been made, and the degree of responsibility the auditor is taking.
D. The degree of responsibility the auditor is taking.

AACSB: Analytical Thinking
AICPA: BB Legal
AICPA: FN Decision Making
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: 2 Medium
Learning Objective: 02-09 Understand that auditing standards are established by both U.S. and international standard setters.
Learning Objective: 02-10 Be familiar with the 10 "generally accepted auditing standards" and the "principles underlying an audit conducted in accordance with generally accepted auditing standards.'
Topic: Auditing Standards

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49. Which of the following best describes what is meant by generally accepted auditing standards?

A. Audit assertions generally determined on audit engagements.
B. Acts to be performed by the auditor.
C. Standards of quality for the auditor's performance.
D. Procedures to be used to gather evidence to support financial statements.

AACSB: Analytical Thinking
AICPA: BB Legal
AICPA: FN Measurement
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: 3 Hard
Learning Objective: 02-09 Understand that auditing standards are established by both U.S. and international standard setters.
Learning Objective: 02-10 Be familiar with the 10 "generally accepted auditing standards" and the "principles underlying an audit conducted in accordance with generally accepted auditing standards."
Topic: Auditing Standards

50. The fourth PCAOB standard of reporting requires an auditor to render a report whenever an auditor's name is associated with financial statements. The overall purpose of the fourth standard of reporting is to require that reports

A. State that the examination of financial statements has been conducted in accordance with generally accepted auditing standards.
B. Indicate the character of the auditor's examination and the degree of responsibility assumed by the auditor.
C. Imply that the auditor is independent in fact as well as in appearance with respect to the financial statements under examination.
D. Express whether the accounting principles used in preparing the financial statements have been applied consistently in the period under examination.

AACSB: Communication
AICPA: BB Legal
AICPA: FN Reporting
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: 3 Hard

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Learning Objective: 02-09 Understand that auditing standards are established by both U.S. and international standard setters.
Learning Objective: 02-10 Be familiar with the 10 "generally accepted auditing standards" and the "principles underlying an audit conducted in accordance with generally accepted auditing standards."
Topic: Auditing Standards

51. The three PCAOB standards of fieldwork are concerned with

A. Planning and supervision and understanding the auditee's internal control system.
B. Choosing evidence with due professional care.
C. Adequate training to understand the auditee's internal controls system.
D. Ensuring consistency in financial statements for periods presented.

AACSB: Communication
AICPA: BB Legal
AICPA: FN Reporting
Accessibility: Keyboard Navigation
Blooms: Remember
Difficulty: 3 Hard
Learning Objective: 02-09 Understand that auditing standards are established by both U.S. and international standard setters.
Learning Objective: 02-10 Be familiar with the 10 "generally accepted auditing standards" and the "principles underlying an audit conducted in accordance with generally accepted auditing standards."
Topic: Auditing Standards

52. The fourth PCAOB reporting standard requires the auditor's report to contain either an expression of opinion regarding the financial statements taken as a whole or an assertion to the effect that an opinion cannot be expressed. The objective of the fourth standard is to prevent

A. An auditor from reporting on one basic financial statement and not the others.
B. An auditor from expressing different opinions on each of the basic financial statements.
C. Management from reducing its final responsibility for the basic financial statements.
D. Misinterpretations regarding the degree of responsibility the auditor is assuming.

AACSB: Communication
AICPA: BB Legal
AICPA: FN Reporting
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: 3 Hard

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Learning Objective: 02-09 Understand that auditing standards are established by both U.S. and international standard setters.
Learning Objective: 02-10 Be familiar with the 10 "generally accepted auditing standards" and the "principles underlying an audit conducted in accordance with generally accepted auditing standards."
Topic: Auditing Standards

Short Answer Questions

53. The IAASB and the ASB have collaborated on the principles underlying an audit conducted in accordance with generally accepted auditing standards. These principles are grouped into four categories. What are the four categories?

The four categories of principles are: 1. Purpose and premise of an audit; 2. Personal responsibilities of the auditor; 3. Auditor actions in performing the audit; and 4. Reporting.

AACSB: Communication
AICPA: BB Legal
AICPA: FN Reporting
Blooms: Remember
Difficulty: 1 Easy
Learning Objective: 02-09 Understand that auditing standards are established by both U.S. and international standard setters.
Learning Objective: 02-10 Be familiar with the 10 "generally accepted auditing standards" and the "principles underlying an audit conducted in accordance with generally accepted auditing standards."
Topic: Auditing Standards

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54. The principles underlying an audit conducted in accordance with generally accepted auditing standards are grouped into four categories. The second category is that of "personal responsibility of the auditor." Generally explain what is intended by this principle.

Auditors are responsible for having appropriate competence and capabilities to perform the audit; complying with relevant ethical requirements; and maintaining professional skepticism and exercising professional judgment, throughout the planning and performance of the audit.

AACSB: Communication
AICPA: BB Legal
AICPA: FN Reporting
Blooms: Understand
Difficulty: 2 Medium
Learning Objective: 02-09 Understand that auditing standards are established by both U.S. and international standard setters.
Learning Objective: 02-10 Be familiar with the 10 "generally accepted auditing standards" and the "principles underlying an audit conducted in accordance with generally accepted auditing standards."
Topic: Auditing Standards

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55. You are the owner of a small grocery store, Corner Marketplace. Explain the five process categories and how they apply to your business.

Financing: The financing process involves loans or shareholder capital financing for assets such as land, buildings, and equipment. Corner Marketplace may have a bank loan or lease for its store. It may also have solicited other means of financing, such as additional owner funds.
Purchasing: Businesses acquire goods and services to support the sale of their own goods or services through the purchasing process. Corner Marketplace would purchase food inventory to sell to customers. It might also need to purchase display cases, freezers, etc. to store and display the inventory.
Human Resource Management: Business organizations hire personnel to perform various functions in accordance with the enterprise's mission and strategy. Corner Marketplace should have established policies for hiring, training, evaluating, counseling, promoting, compensating, and terminating employees.
Inventory Management: A grocery store would have significant inventory to manage, which it accomplishes as part of the inventory management process. The store would need to allocate proper costs to inventory and would need to account for produce, etc. that is expired.
Revenue: Corner Marketplace would generate revenue through sales of food to customers and would collect the proceeds of those sales. Typically, a small grocery store would not have accounts receivables from customers, as customers would pay immediately. However, the revenue cycle includes cash receipts and credit card transactions.

AACSB: Analytical Thinking
AICPA: BB Industry
AICPA: FN Measurement
Blooms: Apply
Difficulty: 3 Hard
Learning Objective: 02-06 Recognize that an audit is shaped by the auditee's business; industry; and economic environment; and understand the essential components and processes characteristic of most business entities.
Learning Objective: 02-07 Be familiar with a five-component model of business processes used to organize an audit.
Topic: A Model of Business

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56. Define corporate governance, the board of directors, and the audit committee and explain how they relate to each other.

Corporate governance is all the people, processes, and activities in place to help ensure proper stewardship over an entity's assets. The *board of directors* is the body primarily responsible for management oversight in corporations. The *audit committee* oversees internal and external audit work done for an entity.

The board of directors plays a part in ensuring proper corporate governance by holding management responsible for the usage of the entity's assets. The audit committee is made up of members of the board of directors. The audit committee enhances corporate governance by holding management accountable for its activities through audits of its work.

AACSB: Analytical Thinking
AICPA: BB Critical Thinking
AICPA: FN Measurement
Blooms: Understand
Difficulty: 2 Medium
Learning Objective: 02-06 Recognize that an audit is shaped by the auditee's business; industry; and economic environment; and understand the essential components and processes characteristic of most business entities.
Topic: A Model of Business

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57. Describe the organizations involved in standard setting for auditors in the United States and what their respective roles are in setting current auditing standards for companies in the United States.

Most auditing standards were developed by the AICPA's Accounting Standards Board (ASB). At that time, the profession was self-regulated. However, the Sarbanes-Oxley Act of 2002 transferred the authority to set auditing standards for public company audits to the Public Company Accounting Oversight Board (PCAOB), which is overseen by the Securities and Exchange Commission (SEC). However, the PCAOB adopted the ASB's auditing standards on an interim basis. CPAs must still abide by the AICPA's Code of Professional Conduct at all times. They must also follow auditing standards set by the ASB when performing audits of private companies and other nonpublic entities. The ASB has replaced the 10 GAAS with a more comprehensive and coherent description of the principles underlying an audit conducted in accordance with generally accepted auditing standards.

AACSB: Ethics
AICPA: BB Legal
AICPA: FN Decision Making
Blooms: Understand
Difficulty: 3 Hard
Learning Objective: 02-04 Understand the significant changes that have taken place in the auditing profession over the past decade.
Learning Objective: 02-08 Identify and be familiar with the major organizations that affect the public accounting profession's environment.
Learning Objective: 02-09 Understand that auditing standards are established by both U.S. and international standard setters.
Learning Objective: 02-10 Be familiar with the 10 "generally accepted auditing standards" and the "principles underlying an audit conducted in accordance with generally accepted auditing standards."
Topic: A Decade of Challenge and Change for Financial Statement Auditors
Topic: A Model of Business
Topic: Auditing Standards

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58. What are the three PCAOB general auditing standards found within the 10 GAAS (NOT the three main categories of GAAS) and why is each important?

The first standard states that an auditor must have adequate training and proficiency as an auditor. This is gained through formal education, continuing education programs, and experience. This ongoing training is necessary so auditors can remain up-to-date with current developments in the industry.

The second standard requires that the auditor maintain an attitude of independence on an engagement. Auditors must be independent in fact and in appearance to protect the public and promote the profession's image of objectivity.

The third standard focuses on due professional care, which means that the auditor plans and performs his or her duties with a degree of skill commonly possessed by others in the profession. It is important that anyone who practices as a CPA is able to offer services based on due professional care.

AACSB: Communication
AICPA: BB Lega
AICPA: FN Measurement
Blooms: Apply
Difficulty: 1 Easy
Learning Objective: 02-09 Understand that auditing standards are established by both U.S. and international standard setters.
Learning Objective: 02-10 Be familiar with the 10 "generally accepted auditing standards" and the "principles underlying an audit conducted in accordance with generally accepted auditing standards."
Topic: Auditing Standards

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59. Jane Goodperson performed an audit on the Quagmire Corporation and issued an unqualified opinion. Jane performed the audit with due professional care and in accordance with generally accepted auditing standards. Two months after the report is issued, Jane discovers on the news that the CEO of Quagmire, Johnny Best, had been stealing small amounts of inventory. The amount, however, is immaterial compared to the overall inventory of the corporation. Jane soon receives a call from Quagmire's CFO, Mark Beastly. Mark wants Jane to refund her audit fees. Mark thinks Jane did not properly perform the audit, as she did not discover this fraud. Further, he feels that now Quagmire's financial statements are not fairly stated because of Jane. How should Jane respond to this claim?

Jane should tell Mark that her responsibility was to plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud. She had no responsibility to plan and perform the audit to obtain reasonable assurance that misstatements, whether caused by errors or fraud, which are not material to the financial statements will be detected. Quagmire's management, not Jane, has responsibility for the financial statements. In fact, because of the Sarbanes-Oxley Act of 2002, Mark had to assume explicit responsibility for the financial statements by "certifying" that he, as CFO, is responsible for establishing and maintaining internal control and that the financial statements fairly present the entity's financial conditions and operations. This statement is probably still true, since the amount stolen was immaterial.

AACSB: Communication
AICPA: BB Legal
AICPA: FN Risk Analysis
Blooms: Apply
Difficulty: 2 Medium
Learning Objective: 02-05 Know that management is primarily responsible for the entity's financial statements and understand the auditor's responsibility for detecting errors; material fraud; and illegal acts.
Topic: Society's Expectations and the Auditor's Responsibilities

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60. Mike has just graduated from State University with a bachelor's degree in accounting. He would like to pursue a career in auditing. What options does Mike have? Describe three auditing career options, including a description of the organization Mike would work for.

Answer could include any three of the following:

External: Mike could become an external auditor. He would work for a CPA firm providing independent audits to nonpublic or public companies. Mike would need to pass the Uniform CPA Examination monitored by the American Institute of Certified Public Accountants. His state may have other requirements, such as 150 credit hours and experience.
Internal: Mike could also be an internal auditor. He would be directly employed by the entity for which he is performing audits. Internal auditors may conduct financial, internal control, compliance, operational, and forensic audits within their organization. Internal auditors are supported by the Institute of Internal Auditors.
Governmental: Another option for Mike is governmental auditing. This is essentially a form of internal auditing and Mike could be employed by federal (such as the Government Accountability Office or the Internal Revenue Service), state, or local agencies.
Forensic: Mike could also be a forensic auditor. Forensic auditors are employed by corporations, government agencies, public accounting firms, and consulting and investigative services firms. They are trained in detecting, investigating, and deterring fraud and white-collar crime and are supported by the Association of Certified Fraud Examiners.

AACSB: Communication
AICPA: BB Industry
AICPA: FN Decision Making
Blooms: Remember
Difficulty: 2 Medium
Learning Objective: 02-01 Be familiar with the different types of auditors.
Topic: Types of Auditors

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61. With respect to an entity's financial statements, describe both the responsibility of management and that of the auditor.

The financial statements are the responsibility of management. The auditor's responsibility is to express an opinion on the financial statements based on the audit.

AACSB: Communication
AICPA: BB Critical Thinking
AICPA: FN Decision Making
Blooms: Understand
Difficulty: 1 Easy
Learning Objective: 02-05 Know that management is primarily responsible for the entity's financial statements and understand the auditor's responsibility for detecting errors; material fraud; and illegal acts.
Topic: Society's Expectations and the Auditor's Responsibilities

62. What auditing standards are used to conduct an audit for a privately-held corporation? What auditing standards are used to conduct an audit for a publicly-traded corporation? What organization is responsible for setting each of these sets of standards?

Auditing standards developed by the AICPA's Auditing Standards Board (ASB) are used to conduct an audit for a privately-held corporation or other entities that are nonpublic companies. This includes the principles underlying an audit conducted in accordance with generally accepted auditing standards and the ASB's Statements on Auditing Standards (SAS).
Auditing standards developed by the Public Company Accounting Oversight Board (PCAOB) must be used to conduct an audit for a publicly-traded corporation. These standards include all those issued by the ASB through 2003, which were codified by the PCAOB, and any new standards issued by the PCAOB after that point.

AACSB: Communication
AICPA: BB Legal
AICPA: FN Reporting
Blooms: Remember
Difficulty: 2 Medium
Learning Objective: 02-09 Understand that auditing standards are established by both U.S. and international standard setters.
Learning Objective: 02-10 Be familiar with the 10 "generally accepted auditing standards" and the "principles underlying an audit

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conducted in accordance with generally accepted auditing standards.'
Topic: Auditing Standards

63. There are several types of audit services that are provided by auditors. Identify and define three of these types of audits.

Answer should include any three of the following:

Financial Statement Audit: Auditors test the transactions, balances, and disclosures in a set of financial statements to determine if they are materially correct.
Internal Control Audit: Auditors test the internal controls of a company to determine whether the control system is functioning effectively (i.e. preventing, or detecting and correcting, misstatements in the financial statements).
Compliance Audit: Auditors test the extent to which rules, policies, laws, covenants, or government regulations are followed by the entity.
Operational Audit: Auditors review part or all of an organization's activities to evaluate whether resources are being used effectively and efficiently. The auditor assesses the entity's performance, identifies areas for improvement, and develops recommendations.
Forensic Audit: Auditors conduct forensic audits to detect or deter fraudulent activities.

AACSB: Communication
AICPA: BB Industry
AICPA: FN Reporting
Blooms: Remember
Difficulty: 2 Medium
Learning Objective: 02-02 Be familiar with the various types of audit; attest; and assurance services offered by accounting professionals.
Topic: Types of Other Audit, Attest, and Assurance Services

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