Auditing and Assurance Services 17th edition Arens Test Bank

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Auditing and Assurance Services, 17e **(Arens/Elder/Beasley)**
Chapter 2 The CPA Profession

2.1 Learning Objective 2-1

1) The legal right to perform audits is granted to a CPA firm by regulation of
A) each state.
B) the Financial Accounting Standards Board (FASB).
C) the American Institute of Certified Public Accountants (AICPA).
D) the Auditing Standards Board.
Answer: A
Terms: Legal rights to perform audits
Difficulty: Moderate
Objective: LO 2-1
AACSB: Reflective thinking

2) Which of the following is **not** a characteristic of a small local CPA firm?
A) Most small firms have fewer than 25 professionals.
B) Small firms perform audits on small and not-for-profit businesses.
C) Tax services are more important than auditing services to the small firm.
D) Small firms are prohibited by the SEC from auditing publicly traded companies.
Answer: D
Terms: Characteristics of a small firm
Difficulty: Moderate
Objective: LO 2-1
AACSB: Reflective thinking

3) Sarbanes-Oxley and the Securities and Exchange Commission restrict auditors from providing many consulting services to their publicly traded audit clients. Which of the following is true for auditors of publicly traded companies?
I. They are restricted from providing consulting services to privately held companies.
II. There is no restriction on providing consulting services to non-audit clients.
A) I only
B) II only
C) I and II
D) Neither I nor II
Answer: B
Terms: Sarbanes-Oxley and Securities Exchange Commission restrictions
Difficulty: Moderate
Objective: LO 2-1
AACSB: Reflective thinking

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4) Which of the following does **not** describe a size category for a CPA firm?
A) Big Four national firms
B) Big Four international firms
C) local firms
D) national and regional firms
Answer: A
Terms: Three categories for describing size of audit firms
Difficulty: Easy
Objective: LO 2-1
AACSB: Reflective thinking

5) _____ is one of the Big Four international CPA firms.
A) Deloitte
B) KPMG
C) Ernst & Young
D) All of the above are classified as Big Four international CPA firms.
Answer: D
Terms: Three categories for describing size of audit firms
Difficulty: Easy
Objective: LO 2-1
AACSB: Reflective thinking

6) In which type of service does the CPA assemble the financial statements but provide no assurance to third parties?
A) audit
B) compilation
C) review
D) bookkeeping
Answer: B
Terms: Compilation
Difficulty: Moderate
Objective: LO 2-1
AACSB: Reflective thinking

7) _____ is **not** one of the National/Regional CPA Firms.
A) PwC
B) BDO USA
C) Grant Thornton
D) RSM US.
Answer: A
Terms: Three categories for describing size of audit firms
Difficulty: Easy
Objective: LO 2-1
AACSB: Reflective thinking

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8) Which of the following is **not** an accurate definition or description of a local CPA firm?
A) Some local CPA firms have several offices.
B) Local CPA firms do not compete for clients with the Big Four CPA firms.
C) Some local CPA firms are affiliated with other CPA firms to share resources.
D) Many local CPA firms provide primarily accounting and tax services to their clients only.
Answer: B
Terms: Three categories for describing size of audit firms
Difficulty: Moderate
Objective: LO 2-1
AACSB: Reflective thinking

9) Many small, local accounting firms perform audits as their primary service to their clients.
Answer: FALSE
Terms: Small accounting firms do not perform audits as their primary service to their clients
Difficulty: Easy
Objective: LO 2-1
AACSB: Reflective thinking

10) Sarbanes-Oxley and the Securities and Exchange Commission restrict auditors from providing many consulting services to their publicly traded audit clients.
Answer: TRUE
Terms: Sarbanes-Oxley and Securities Exchange Commission restrictions
Difficulty: Easy
Objective: LO 2-1
AACSB: Reflective thinking

11) Small local CPA Firms are allowed under Sarbanes-Oxley and the Securities and Exchange Commission a special exemption to perform audits of publicly-listed firms.
Answer: FALSE
Terms: Sarbanes-Oxley and Securities and Exchange Commission restrictions
Difficulty: Easy
Objective: LO 2-1
AACSB: Reflective thinking

12) In addition to attestation and assurance services, CPA firms provide other services to their clients. List three of these services.
Answer: Other services performed by a CPA firm include:
- accounting and bookkeeping services
- tax services
- management consulting and risk advisory services.

Terms: Activities of CPA firms
Difficulty: Moderate
Objective: LO 2-1
AACSB: Reflective thinking

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2.2 Learning Objective 2-2

1) Which of the following statements is true as it relates to limited liability partnerships?
A) Only senior partners are liable for the partnership's debts.
B) Partners have no liability in a limited liability partnership arrangement.
C) Partners are personally liable for the acts of those under their supervision.
D) All partners must be AICPA members.
Answer: C
Terms: Limited liability partnerships
Difficulty: Challenging
Objective: LO 2-2
AACSB: Reflective thinking

2) Which staff level in a CPA firm performs most of the detailed audit work?
A) partner
B) staff assistant
C) senior auditor
D) senior manager
Answer: B
Terms: Staff levels in CPA firm
Difficulty: Easy
Objective: LO 2-2
AACSB: Reflective thinking

3) Which staff level in a CPA firm manages the overall relationship with the client and manages the audit, in general?
A) the audit partner
B) the audit staff assistant
C) the senior or in-charge auditor with 2-5 years' experience
D) the audit manager
Answer: D
Terms: Staff levels in CPA firm
Difficulty: Easy
Objective: LO 2-2
AACSB: Reflective thinking

4) All of the Big Four accounting firms and many of the smaller CPA firms now operate as limited liability partnerships.
Answer: TRUE
Terms: Limited liability partnerships
Difficulty: Easy
Objective: LO 2-2
AACSB: Reflective thinking

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5) Limited liability companies are structured and taxed like a general partnership, but their owners have limited personal liability similar to that of a general corporation.
Answer: TRUE
Terms: Limited liability companies
Difficulty: Moderate
Objective: LO 2-2
AACSB: Reflective thinking

6) In a CPA firm, the audit partner coordinates the performance of audit procedures.
Answer: FALSE
Terms: Staff levels in CPA firm
Difficulty: Easy
Objective: LO 2-2
AACSB: Reflective thinking

7) In a CPA firm, the audit senior or the in-charge auditor performs most of the detailed audit work.
Answer: FALSE
Terms: Staff levels in CPA firm
Difficulty: Easy
Objective: LO 2-2
AACSB: Reflective thinking

8) List and describe the three factors that influence the organizational structure of all CPA firms. What are the most common forms of CPA firm organization?
Answer: The three factors that influence the organization of a CPA firm include:
1. The need for independence from clients. Independence permits auditors to remain unbiased in drawing conclusions about the financial statements.
2. The importance of a structure to encourage competence. Competency permits auditors to conduct audits and perform other services effectively and efficiently.
3. The increased litigation risk faced by auditors. Audit firms continue to experience increases in litigation-related costs. Some organizational structures afford a degree of protection to individual firm members.

Common forms of audit firm organization include:

- Proprietorship
- General Partnership
- General Corporation
- Professional Corporation
- Limited Liability Company
- Limited Liability Partnership

Terms: Factors that influence the organizational structure of CPA firms
Difficulty: Moderate
Objective: LO 2-2
AACSB: Reflective thinking

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9) List and describe the six organizational structures available to CPA firms.
Answer: CPA firms can take one of six organizational forms:
• *Proprietorship.* This form is limited to firms with only one owner.
• *General partnership*. This form is similar to a proprietorship, except that it applies to multiple owners.
• *General corporation*. Shareholders in a general corporation are liable only to the extent of their investment in the corporation. Many states prohibit CPA firms from organizing as a general corporation.
• *Professional corporation*. A professional corporation provides professional services and is owned by one or more shareholders. Personal liability protection for shareholders in professional corporations varies widely from state to state.
• *Limited liability company*. This form combines the most favorable attributes of a general corporation and a general partnership. LLCs are typically structured and taxed like a general partnership, but its owners have limited personal liability similar to that of a general corporation.
• *Limited liability partnership*. An LLP is owned by one or more partners. It is structured and taxed like a general partnership. However, the personal liability protection of an LLP is less than that of a general corporation or an LLC, but it is greater than a general partnership. Many accounting firms now operate as LLPs.
Terms: Organizational structures available to CPA firms
Difficulty: Moderate
Objective: LO 2-2
AACSB: Reflective thinking

2.3 Learning Objective 2-3

1) The organization that is responsible for providing oversight for auditors of public companies is called the
A) Auditing Standards Board.
B) American Institute of Certified Public Accountants.
C) Public Oversight Board.
D) Public Company Accounting Oversight Board.
Answer: D
Terms: Organization responsible for providing oversight for auditors of public companies
Difficulty: Easy
Objective: LO 2-3
AACSB: Reflective thinking

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2) Members of the Public Company Accounting Oversight Board are appointed and overseen by the
A) U.S. Congress.
B) American Institute of Certified Public Accountants.
C) Auditing Standards Board.
D) Securities and Exchange Commission.
Answer: D
Terms: Members of Public Company Accounting Oversight Board
Difficulty: Easy
Objective: LO 2-3
AACSB: Reflective thinking

3) The Public Company Accounting Oversight Board
A) performs inspections of the quality controls of firms that audit public companies.
B) establishes auditing standards that must be followed by CPAs on all audits.
C) oversees auditors of private companies.
D) performs all of the above functions.
Answer: A
Terms: Public Company Accounting Oversight Board
Difficulty: Moderate
Objective: LO 2-3
AACSB: Reflective thinking

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4) Assume the Public Company Accounting Oversight Board (PCAOB) identifies a violation during its inspection of a registered accounting firm. The PCAOB

A)

can enforce disciplinary action against the accounting firm	report the matter to the Securities and Exchange Commission	suspend the license to practice of the CPA guilty of the violation
Yes	Yes	Yes

B)

can enforce disciplinary action against the accounting firm	report the matter to the Securities and Exchange Commission	suspend the license to practice of the CPA guilty of the violation
Yes	Yes	No

C)

can enforce disciplinary action against the accounting firm	report the matter to the Securities and Exchange Commission	suspend the license to practice of the CPA guilty of the violation
Yes	No	No

D)

can enforce disciplinary action against the accounting firm	report the matter to the Securities and Exchange Commission	suspend the license to practice of the CPA guilty of the violation
No	No	No

Answer: B
Terms: Public Company Accounting Oversight Board inspection violations
Difficulty: Moderate
Objective: LO 2-3
AACSB: Reflective thinking

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5) Has audit quality improved since the passage of Sarbanes-Oxley Act (SOX)? Which of the following statements is true with regards to audit quality since the passage of SOX?
A) The frequency of financial statement restatements has increased since SOX.
B) PCAOB audit engagement findings continue to document a high level of audit deficiencies.
C) Finally, the auditing professions agrees on the definition of audit quality.
D) No progress has been made on the definition of what are called "Audit Quality Indicators" since SOX.
Answer: B
Terms: Public Company Accounting Oversight Board
Difficulty: Moderate
Objective: LO 2-3
AACSB: Reflective thinking

6) The Public Company Accounting Oversight Board (PCAOB) provides oversight to auditors of publicly traded and private companies.
Answer: FALSE
Terms: Public Company Accounting Oversight Board
Difficulty: Easy
Objective: LO 2-3
AACSB: Reflective thinking

7) The PCAOB requires annual inspections of accounting firms that audit more than ten public companies.
Answer: FALSE
Terms: Public Company Accounting Oversight Board
Difficulty: Moderate
Objective: LO 2-3
AACSB: Reflective thinking

8) The PCAOB requires annual inspections of other registered accounting firms that audit less than 100 publicly listed companies at least once every 3 years.
Answer: TRUE
Terms: Public Company Accounting Oversight Board
Difficulty: Moderate
Objective: LO 2-3
AACSB: Reflective thinking

9) The Sarbanes-Oxley Act established the Public Company Accounting Oversight Board (PCAOB). What are the PCAOB's primary functions?
Answer: The PCAOB provides oversight for auditors of public companies; establishes auditing, attestation, and quality control standards for public company audits; and performs inspections of audit engagements as well as the quality controls at audit firms performing those audits.
Terms: Sarbanes-Oxley Act; Public Company Accounting Oversight Board primary functions
Difficulty: Moderate
Objective: LO 2-3
AACSB: Reflective thinking

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2.4 Learning Objective 2-4

1) The form that must be completed and filed with the Securities and Exchange Commission whenever a company experiences a significant event that is of interest to public investors is the
A) Form S-1.
B) Form 8-K.
C) Form 10-K.
D) Form 10-Q.
Answer: B
Terms: SEC Form 8-K, reporting significant events
Difficulty: Moderate
Objective: LO 2-4
AACSB: Reflective thinking

2) The form that must be filed with the Securities and Exchange Commission whenever a company plans to issue new securities to the public is the
A) Form S-1.
B) Form 8-K.
C) Form 10-K.
D) Form 10-Q.
Answer: A
Terms: Form must be completed and filed with Securities and Exchange Commission when company plans to issue new securities
Difficulty: Moderate
Objective: LO 2-4
AACSB: Reflective thinking

3) Which of the following is a correct statement regarding the SEC?
A) The Securities Act of 1934 requires most companies planning to issue new securities to the public to submit a registration statement to the SEC for approval.
B) All public companies must file monthly statements with the SEC.
C) The Form 10-K must be filed within 30 days after the close of the fiscal year.
D) The SEC has the power to establish rules for any CPA associated with audited financial statements submitted to the commission.
Answer: D
Terms: Securities and Exchange Commission
Difficulty: Challenging
Objective: LO 2-4
AACSB: Reflective thinking

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4) With respect to the SEC,
A) the attitude of the SEC is generally considered in any major change proposed by the FASB.
B) the SEC is the sole agency responsible for setting generally accepted accounting principles.
C) the SEC requirements of greatest interest to CPAs are set forth in their enforcement regulations.
D) the SEC has the power to establish rules for all CPAs.
Answer: A
Terms: Securities and Exchange Commission influence on setting generally accepted accounting principles
Difficulty: Moderate
Objective: LO 2-4
AACSB: Reflective thinking

5) Which of the following is **not** a publication issued by the Securities and Exchange Commission?
A) Accounting and Auditing Enforcement Actions
B) Accounting Series Releases
C) Regulation S-X
D) State Board of Accountancy Enforcement Actions
Answer: D
Terms: Securities and Exchange Commission
Difficulty: Moderate
Objective: LO 2-4
AACSB: Reflective thinking

6) The difference between the Securities Act of 1933 and the Securities Act of 1934 is that only the 1934 Act requires audited financial statements.
Answer: FALSE
Terms: Securities Acts of 1933 and 1934
Difficulty: Easy
Objective: LO 2-4
AACSB: Reflective thinking

7) Form 10-K must be filed with the SEC whenever a public company experiences a significant event.
Answer: FALSE
Terms: Form 10-K; SEC
Difficulty: Moderate
Objective: LO 2-4
AACSB: Reflective thinking

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8) The overall purpose of the Securities and Exchange Commission is to assist in providing investors with reliable information upon which to make investment decisions.
Answer: TRUE
Terms: Securities and Exchange Commission
Difficulty: Moderate
Objective: LO 2-4
AACSB: Reflective thinking

9) Form 10-Q must be filed monthly with the Securities and Exchange Commission by every publicly held company.
Answer: FALSE
Terms: Form 10-Q; SEC
Difficulty: Moderate
Objective: LO 2-4
AACSB: Reflective thinking

10) Discuss the purpose of the Securities and Exchange Commission and its influence on setting generally accepted accounting principles.
Answer: The SEC, an agency of the federal government, assists in providing investors with reliable information upon which to make investment decisions. The SEC has considerable influence in setting generally accepted accounting principles (GAAP) and disclosure requirements for financial statements as a result of its authority for specifying reporting requirements considered necessary for fair disclosure to investors. The SEC has the power to establish rules for any CPA associated with audited financial statements submitted to the commission. The attitude of the SEC is generally considered in any major change proposed by the Financial Accounting Standards Board (FASB), the independent organization that establishes U.S. GAAP.
Terms: Securities and Exchange Commission influence on setting generally accepted accounting principles
Difficulty: Moderate
Objective: LO 2-4
AACSB: Reflective thinking

2.5 Learning Objective 2-5

1) Statements on Standards for Accounting and Review Services (SSARS) are issued by the
A) Accounting and Review Services Committee.
B) Professional Ethics Executive Committee.
C) Securities and Exchange Commission.
D) Financial Accounting Standards Board.
Answer: A
Terms: Statements on Standards for Accounting and Review Services (SSARS)
Difficulty: Moderate
Objective: LO 2-5
AACSB: Reflective thinking

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2) The American Institute of Certified Public Accountants (AICPA)
A) is responsible for issuing licenses to new CPAs.
B) restricts its membership to CPAs who are independent auditors.
C) sets auditing standards for both public and private companies.
D) sets rules of conduct that CPAs are required to meet.
Answer: D
Terms: AICPA has authority to establish standards and rules
Difficulty: Moderate
Objective: LO 2-5
AACSB: Reflective thinking

3) In 2017, the American Institute of CPAs joined with which of the following to form the Association of International Certified Public Accountants?
A) the Chartered Institute of Management Accountants
B) the Securities and Exchange Commission
C) the Public Accounting Oversight Board
D) the Japanese Institute of Certified Public Accountants
Answer: A
Terms: AICPA joins with the CIMA (Chartered Institute of Management Accountants)
Difficulty: Moderate
Objective: LO 2-5
AACSB: Reflective thinking

4) Membership in the AICPA is restricted to CPAs who are currently practicing as independent auditors.
Answer: FALSE
Terms: Membership in AICPA
Difficulty: Easy
Objective: LO 2-5
AACSB: Reflective thinking

5) Membership in the AICPA is mandatory for all licensed practicing CPAs.
Answer: FALSE
Terms: Membership in AICPA
Difficulty: Easy
Objective: LO 2-5
AACSB: Reflective thinking

6) A CPA must meet continuing education requirements to maintain their license to practice.
Answer: TRUE
Terms: Membership in AICPA
Difficulty: Easy
Objective: LO 2-5
AACSB: Reflective thinking

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7) The Auditing Standards Board (ASB) of the AICPA is responsible for issuing pronouncements on auditing matters in the U.S. for the audits of every type of entity.
Answer: TRUE
Terms: AICPA Standards and Rules
Difficulty: Easy
Objective: LO 2-5
AACSB: Reflective thinking

8) What are the major functions of the AICPA?
Answer: Major functions of the AICPA include:
- Setting standards and rules that all members and other practicing CPAs must follow. These standards consist of auditing standards for auditors of private companies, compilation and review standards, other attestation standards, and the *Code of Professional Conduct*.
- Research and publication on many different subjects related to accounting, auditing, attestation and assurance services, management consulting services, and taxes. AICPA publications include the *Journal of Accountancy*, industry audit guides for several industries, periodic updates of the *Codification of Statements on Auditing Standards*, and the *Code of Professional Conduct*.
- Promoting the accounting profession through organizing national advertising campaigns
- Promoting new assurance services
- Developing specialist certifications to help market and ensure the quality of services in specialized practice areas
- Writing and grading the uniform CPA examination
- Providing continuing education seminars for its members

Terms: Major functions of AICPA
Difficulty: Challenging
Objective: LO 2-5
AACSB: Reflective thinking

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2.6 Learning Objective 2-6

1) Which of the following are audit standards used in professional practice by audit firms?
A)

International Standards on Auditing	AICPA Auditing Standards	PCAOB Auditing Standards
Yes	No	No

B)

International Standards on Auditing	AICPA Auditing Standards	PCAOB Auditing Standards
Yes	Yes	No

C)

International Standards on Auditing	AICPA Auditing Standards	PCAOB Auditing Standards
Yes	Yes	Yes

D)

International Standards on Auditing	AICPA Auditing Standards	PCAOB Auditing Standards
No	Yes	Yes

Answer: C
Terms: Standards used in professional practice
Difficulty: Easy
Objective: LO 2-6
AACSB: Reflective thinking

2) Who is responsible for establishing auditing standards for privately held companies?
A) Securities and Exchange Commission
B) Public Company Accounting Oversight Board
C) Auditing Standards Board
D) National Association of Accounting
Answer: C
Terms: Establishing auditing standards for privately held companies
Difficulty: Easy
Objective: LO 2-6
AACSB: Reflective thinking

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3) Standards issued by the Public Company Accounting Oversight Board must be followed by CPAs who audit
A) both private and public companies.
B) public companies only.
C) private companies, public companies, and nonprofit entities.
D) private companies only.
Answer: B
Terms: Public Company Accounting Oversight Board Standards
Difficulty: Moderate
Objective: LO 2-6
AACSB: Reflective thinking

4) The International Standards on Auditing (ISA)
A) are issued by the AICPA.
B) override a country's regulations governing the audit of a company.
C) has many of the same standards as the Auditing Standards Board (ASB).
D) must be followed by companies whose stock is traded in the U.S.
Answer: C
Terms: International Standards on Auditing; International Auditing and Assurance Standards Board
Difficulty: Moderate
Objective: LO 2-6
AACSB: Reflective thinking

5) _____ are referred to as U.S. generally accepted auditing standards (GAAS).
A) AICPA auditing standards
B) SEC auditing standards
C) PCAOB auditing standards
D) Sarbanes-Oxley standards
Answer: A
Terms: Auditing standards of the United States
Difficulty: Moderate
Objective: LO 2-6
AACSB: Reflective thinking

6) Which of the following is a true statement regarding auditing standards?
A) Prior to the passage of Sarbanes-Oxley, the FASB established auditing principles for U.S. public companies.
B) PCAOB auditing standards are applicable to entities outside the U.S.
C) There are no similarities between PCAOB standards and International Standards on Auditing.
D) The Auditing Standards Board has revised most of its standards to converge with the international standards.
Answer: D
Terms: Auditing standards of the United States and International Standards of Auditing
Difficulty: Easy
Objective: LO 2-6
AACSB: Reflective thinking

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7) Which of the following is true with regards to the various auditing standards?
A) Statements on Auditing Standards (SASs) are issued by the PCAOB.
B) The ASB Clarity Project was intended to make the U.S. auditing standards easier to read, understand, and apply.
C) The ASB redrafted existing AICPA auditing standards to align them with respective International Standards on Auditing (ISA's).
D) Both B and C are correct.
Answer: D
Terms: Auditing standards of the United States and International Standards of Auditing
Difficulty: Challenging
Objective: LO 2-6
AACSB: Reflective thinking

8) Which of the following is **not** one of the main sets of auditing standards around the world today?
A) AICPA Auditing Standards
B) International Standards on Auditing
C) PCAOB Auditing Standards
D) Securities and Exchange Commission Auditing Standards
Answer: D
Terms: Auditing standards of the United States and International Standards on Auditing
Difficulty: Easy
Objective: LO 2-6
AACSB: Reflective thinking

9) The PCAOB considers International Standards on Auditing (ISA) when developing its standards.
Answer: TRUE
Terms: Public Company Accounting Oversight Board Standards
Difficulty: Easy
Objective: LO 2-6
AACSB: Reflective thinking

10) International Standards on Auditing are issued by the International Auditing and Assurance Standards Board (IAASB).
Answer: TRUE
Terms: International Standards on Auditing; International Auditing and Assurance Standards Board
Difficulty: Easy
Objective: LO 2-6
AACSB: Reflective thinking

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11) The ASB has revised its audit standards to converge with international standards.
Answer: TRUE
Terms: Auditing standards of the United States and International Standards on Auditing
Difficulty: Easy
Objective: LO 2-6
AACSB: Reflective thinking

12) International Standards on Auditing (ISAs) override a country's regulations governing the audit of financial or other information.
Answer: FALSE
Terms: International Standards on Auditing
Difficulty: Easy
Objective: LO 2-6
AACSB: Reflective thinking

2.7 Learning Objective 2-7

1) Historically, auditing standards have been organized into three categories, including
A) standards of field work.
B) purpose of an audit.
C) responsibilities of the auditor.
D) proper planning and supervision.
Answer: A
Terms: GAAS, general standards
Difficulty: Easy
Objective: LO 2-7
AACSB: Reflective thinking

2) The "Principles Underlying an Audit in Accordance with Generally Accepted Auditing Principles" provide a framework to help auditors
A) understand the ten GAAS standards.
B) obtain complete assurance that the financial statements are free from any error.
C) report on the financial statements.
D) prevent fraud.
Answer: C
Terms: GAAS; New principles underlying GAAS
Difficulty: Easy
Objective: LO 2-7
AACSB: Reflective thinking

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3) Which of the following is **not** one of the responsibilities of an auditor under the principles underlying an audit of financial statements?
A) possess appropriate competence and capabilities
B) comply with relevant ethical requirements
C) plan work and supervise assistants
D) maintain professional skepticism and exercise professional judgment
Answer: C
Terms: Principles underlying an audit performed in accordance with GAAS
Difficulty: Easy
Objective: LO 2-7
AACSB: Reflective thinking

4) To obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, the auditor must fulfill several performance responsibilities, including
A) verifying that all audit work is performed by a CPA with a minimum of three years' experience.
B) obtaining sufficient, appropriate audit evidence.
C) exercising professional judgment.
D) providing an opinion on the financial statements.
Answer: B
Terms: GAAS- New principles underlying GAAS; Purpose of an audit
Difficulty: Easy
Objective: LO 2-7
AACSB: Reflective thinking

5) The Statements on Auditing Standards issued by the Auditing Standards Board
A) are regarded as authoritative literature.
B) mandate the amount of evidence that must be obtained.
C) must be followed in all situations.
D) are optional guidelines which an auditor may choose to follow or not follow when conducting an audit.
Answer: A
Terms: Generally Accepted Auditing Standards
Difficulty: Moderate
Objective: LO 2-7
AACSB: Reflective thinking

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6) An auditor need not abide by a particular auditing standard if the auditor believes that
A) the issue in question is immaterial in amount.
B) more expertise is needed to fulfill the requirement.
C) the requirement of the standard has not been addressed by the PCAOB.
D) fraud is involved.
Answer: A
Terms: Auditor need not abide by a particular auditing standard
Difficulty: Moderate
Objective: LO 2-7
AACSB: Reflective thinking

7) When assessing the risk of material misstatements in the financial statements,
A) inadequate internal control procedures will mitigate client business risk.
B) GAAS specifies in detail how much and what types of evidence the auditor needs to obtain.
C) company management is responsible for determining materiality levels.
D) the auditor must understand the client's business and industry.
Answer: D
Terms: Generally Accepted Auditing Standards
Difficulty: Moderate
Objective: LO 2-7
AACSB: Reflective thinking

8) In order to properly plan and perform an audit, an important fact for both the auditor and the client to understand is that
A) the internal control policies and procedures are developed by the auditors.
B) the purpose of an audit is to prevent fraud.
C) management is responsible for the preparation of the financial statements.
D) management can restrict the auditor's access to important information relevant to the financial statements.
Answer: C
Terms: GAAS- New principles underlying GAAS; Purpose of an audit
Difficulty: Moderate
Objective: LO 2-7
AACSB: Reflective thinking

9) The principles underlying an audit
A) contain the procedures that must be followed during an audit.
B) carry the same authority as AICPA auditing standards.
C) only apply to the audits of public companies.
D) provide structure for the clarified Codification.
Answer: D
Terms: Principles underlying an audit
Difficulty: Moderate
Objective: LO 2-7
AACSB: Reflective thinking

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10) The AICPA principles underlying an audit are organized around four principles. Which of the following is **not** one of those principles?
A) fairness
B) responsibilities
C) reporting
D) performance
Answer: A
Terms: Principles underlying an audit
Difficulty: Moderate
Objective: LO 2-7
AACSB: Reflective thinking

11) Which of the following statements about Generally Accepted Audit Standards are true?
I. They serve as broad guidelines to auditors for conducting an audit engagement.
II. They are sufficiently specific to provide a meaningful guide to practitioners.
III. They represent a framework upon which the AICPA can provide interpretations.
A) I and II
B) I and III
C) II and III
D) I, II and III
Answer: B
Terms: Generally Accepted Auditing Standards
Difficulty: Challenging
Objective: LO 2-7
AACSB: Reflective thinking

12) The AICPA principles and the auditing standards should be viewed by practitioners as
A) ideals to work towards, but which are not achievable.
B) maximum standards that denote excellent work.
C) minimum standards of performance that must be achieved on each audit engagement.
D) benchmarks to be used on all audits, reviews, and compilations.
Answer: C
Terms: Generally Accepted Auditing Standards (GAAS) and Statements on Auditing Standards (SAS)
Difficulty: Challenging
Objective: LO 2-7
AACSB: Reflective thinking

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13) Which of the following is an accurate statement regarding principles and auditing standards?
A) The principles underlying an audit give specific guidance to an auditor when a problem arises in an audit.
B) The principles underlying an audit state that the only objective of an audit is to provide financial statement users with an opinion.
C) All auditing standards issued by the PCAOB are given two classification numbers.
D) The Statement on Auditing Standard (SAS) number identifies the order in which it was issued in relation to other SASs.
Answer: D
Terms: Principles underlying an audit versus auditing standards
Difficulty: Moderate
Objective: LO 2-7
AACSB: Reflective thinking

14) _____ is an attitude that includes a questioning mind, being alert to conditions that might indicate possible misstatements due to fraud or error, and a critical assessment of audit evidence.
A) Reasonableness
B) Diligence
C) Professional skepticism
D) Competence
Answer: C
Terms: Professional skepticism
Difficulty: Moderate
Objective: LO 2-7
AACSB: Reflective thinking

15) To obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, the auditor fulfills several performance responsibilities, including
A) complying with the AICPA *Code of Professional Conduct*.
B) issuing a written report on the financial statements.
C) determining and applying materiality levels.
D) having the appropriate competence to perform the audit.
Answer: C
Terms: Principles underlying an audit
Difficulty: Moderate
Objective: LO 2-7
AACSB: Reflective thinking

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16) Which of the following is **not** true regarding the purpose of an audit performed on a set of financial statements in accordance with generally accepted auditing standards?
A) to provide users of the financial statements with an opinion on the financial statements
B) to provide users of the financial statements with absolute assurance that the financial statements contain no errors in them
C) to provide financial statement users with an opinion on whether the financial statements are presented fairly or not
D) to provide financial statement users with an opinion in accordance with the applicable financial reporting framework
Answer: B
Terms: Purpose of a GAAS audit
Difficulty: Moderate
Objective: LO 2-7
AACSB: Reflective thinking

17) In situations in which the CPA or the CPA's assistants are not qualified to perform the audit work, which of the following is **not** an option the CPA or the CPA firm has?
A) The CPA and the CPA's assistants have a professional obligation to acquire the required knowledge and skills.
B) The CPA and the CPA's assistants should simply rely more upon the client's representations when performing the audit.
C) The CPA should suggest someone else or another CPA firm which is qualified to perform the work.
D) The CPA should decline the audit engagement.
Answer: B
Terms: Auditor's Responsibilities: Competence and Capabilities
Difficulty: Moderate
Objective: LO 2-7
AACSB: Reflective thinking

18) Professional skepticism must be maintained only if the auditor suspects fraud.
Answer: FALSE
Terms: Generally Accepted Auditing Standards; Responsibilities
Difficulty: Easy
Objective: LO 2-7
AACSB: Reflective thinking

19) Statements on Auditing Standards (SASs) are issued by the Public Company Accounting Oversight Board.
Answer: FALSE
Terms: Statements on Auditing Standards (SAS); Public Company Accounting Oversight Board
Difficulty: Easy
Objective: LO 2-7
AACSB: Reflective thinking

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20) The AU-C number identifies the order in which it was issued in relation to all other codified auditing standards.
Answer: FALSE
Terms: Classification of auditing standards
Difficulty: Moderate
Objective: LO 2-7
AACSB: Reflective thinking

21) Similar to the Financial Accounting Standards Board (FASB) Codification, the AICPA has codified the Statement of Auditing Standards.
Answer: TRUE
Terms: Classification of auditing standards
Difficulty: Moderate
Objective: LO 2-7
AACSB: Reflective thinking

22) The PCAOB website includes a reference tool that identifies the analogous AICPA and IAASB auditing standards for each PCAOB standard.
Answer: TRUE
Terms: Classification of auditing standards
Difficulty: Moderate
Objective: LO 2-7
AACSB: Reflective thinking

23) An auditor should accept the fact that management of an audit client may restrict access to persons within the entity from whom the auditor may need to obtain audit evidence due to client confidentiality.
Answer: FALSE
Terms: Purpose of an Audit
Difficulty: Easy
Objective: LO 2-7
AACSB: Reflective thinking

24) List the four principles underlying an audit.
Answer:
- Purpose of an audit
- Responsibilities
- Performance
- Reporting

Terms: GAAS; New principles underlying GAAS
Difficulty: Easy
Objective: LO 2-7
AACSB: Reflective thinking

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25) Principles related to the auditor's responsibilities in the audit stress three important personal qualities that the auditor should possess. List and discuss these three qualities.
Answer:
1. Appropriate competence and capabilities. The auditor is required to have formal education in auditing and accounting, adequate practical experience for the work being performed, and continuing professional education.
2. Comply with relevant ethical requirements. The AICPA *Code of Professional Conduct* outlines the ethical requirements for CPAs who practice in accounting firms or work in organizations as part of management. The Code and auditing standards stress the need for independence in audit engagements.
3. Maintain professional skepticism and exercise professional judgment. Professional skepticism is an attitude that includes a questioning mind, being alert to conditions that might indicate possible misstatements due to fraud or error, and a critical assessment of audit evidence. In making judgments about the presence of a material misstatement, auditors are responsible for applying relevant training, knowledge, and experience in making informed decisions about the courses of action that are appropriate in the circumstances of the audit engagement.
Terms: Principles underlying an audit
Difficulty: Moderate
Objective: LO 2-7
AACSB: Reflective thinking

26) Performance is one of the principles underlying an audit. List three performance responsibilities.
Answer: Performance responsibilities include:
- obtain reasonable assurance about whether financial statements are free of material misstatement
- plan work and supervise assistants
- determine and apply materiality level(s)
- identify and assess risks of material misstatements based on understanding of the entity and its environment, including internal controls
- obtain sufficient appropriate audit evidence

Terms: Principles underlying an audit
Difficulty: Easy
Objective: LO 2-7
AACSB: Reflective thinking

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2.8 Learning Objective 2-8

1) Quality control for a CPA firm
A) includes the organizational structure of the firm and the procedures it establishes.
B) is tailored to each specific audit engagement.
C) is a guarantee that auditing standards are followed.
D) is required only for firms auditing SEC companies.
Answer: A
Terms: Quality control policies and procedures
Difficulty: Moderate
Objective: LO 2-8
AACSB: Reflective thinking

2) The method used by a CPA firm to ensure that the firm meets its professional responsibilities to clients and others is
A) continuing professional education.
B) compliance with generally accepted reporting standards.
C) quality control.
D) peer review.
Answer: C
Terms: Quality control policies and procedures
Difficulty: Moderate
Objective: LO 2-8
AACSB: Reflective thinking

3) Within the context of quality control, the primary purpose of continuing professional education and training activities is to enable a CPA firm to provide its personnel with
A) technical training that assures proficiency as a valuation expert.
B) professional education that is required in order to perform with due professional care.
C) knowledge required to fulfill assigned responsibilities.
D) knowledge required to perform a peer review.
Answer: C
Terms: Quality control; Continuing professional education and training activities
Difficulty: Moderate
Objective: LO 2-8
AACSB: Reflective thinking

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4) The purpose of establishing quality control policies and procedures to accept or continue a client relationship is to
A) provide reasonable assurance that personnel are adequately trained to fulfill their responsibilities.
B) monitor the risk factors concerning misstatements that arise from the misappropriation of assets.
C) document objective criteria for the CPA firm's peer review.
D) minimize the likelihood of associating with a client whose management may lack integrity.
Answer: D
Terms: Purpose of quality control policies and procedures to accept or continue client relationship
Difficulty: Moderate
Objective: LO 2-8
AACSB: Reflective thinking

5) Which of the following is an element of the CPA's quality control system that should be considered in establishing its quality control policies and procedures?
A) considering audit risk and materiality
B) using statistical sampling techniques
C) assigning appropriately experienced personnel to engagements
D) complying with laws and regulations
Answer: C
Terms: Quality control policies and procedures
Difficulty: Moderate
Objective: LO 2-8
AACSB: Reflective thinking

6) Which of the following is **not** an essential component of quality control?
A) policies and procedures to ensure that firm personnel are actively engaged in marketing strategies
B) policies and procedures to ensure that the work performed by firm personnel meet applicable professional standards
C) policies to ensure that personnel maintain their independence in fact and in appearance
D) policies that ensure that monitoring activities are effectively applied
Answer: A
Terms: Component of quality control
Difficulty: Moderate
Objective: LO 2-8
AACSB: Reflective thinking

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7) Which one of the following is **not** true regarding the American Institute of Certified Public Accountants peer review requirement?
A) A CPA firm must develop and adhere to quality control standards.
B) Peer reviews are mandatory.
C) A CPA firm will lose AICPA eligibility if a peer review is not performed.
D) Firms required to be registered with and inspected by the PCAOB are exempt.
Answer: D
Terms: AICPA peer review
Difficulty: Challenging
Objective: LO 2-8
AACSB: Reflective thinking

8) How often is the AICPA Peer Review Program performed of an AICPA member CPA firm administered by a State CPA Society under the overall direction of the AICPA Peer Review Board?
A) every year
B) every 2 years
C) every 3 years
D) every 5 years
Answer: C
Terms: AICPA CPA Firm Member Peer Review Requirement
Difficulty: Moderate
Objective: LO 2-8
AACSB: Reflective thinking

9) Which of the following is **not** a purpose of the Center for Audit Quality which is affiliated with the AICPA?
A) to serve the capital markets
B) to serve public company auditors
C) to serve investors
D) to serve the International Accounting Standards Board (IASB)
Answer: D
Terms: Audit Practice and Quality Centers
Difficulty: Moderate
Objective: LO 2-8
AACSB: Reflective thinking

10) Quality controls are established for the entire CPA firm whereas auditing standards are applicable to the individual engagement.
Answer: TRUE
Terms: Quality controls and auditing standards
Difficulty: Moderate
Objective: LO 2-8
AACSB: Reflective thinking

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11) In order to be eligible for membership in the AICPA, public accounting firms must be enrolled in an AICPA-approved practice monitoring program. Members of the firm can still be eligible for AICPA membership even if their firms are not enrolled in an AICPA-approved practice monitoring program.
Answer: FALSE
Terms: Peer review requirements
Difficulty: Moderate
Objective: LO 2-8
AACSB: Reflective thinking

12) Discuss the relationship between quality control and generally accepted auditing standards.
Answer: For a CPA firm, quality control comprises the methods used to ensure that the firm meets its professional responsibilities to clients and others. Quality control is closely related to but distinct from auditing standards. The standards recognize that a quality control system can provide only reasonable assurance, not a guarantee that auditing standards are followed. A CPA firm must make sure that auditing standards are followed on every audit. Quality controls are the procedures used by the entire CPA firm to ensure that the principles in auditing standards are followed on every audit. Quality controls are established for the entire CPA firm, whereas auditing standards are applicable to individual engagements.
Terms: Relationship between quality control and generally accepted auditing standards
Difficulty: Easy
Objective: LO 2-8
AACSB: Reflective thinking

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13) List and describe the six elements of quality control. Who establishes the standards for quality control?
Answer:
- *Leadership responsibilities for quality within the firm* – The firm should promote a culture that quality is essential in performing engagements and should establish policies and procedures that support that culture.
- *Relevant ethical requirements* – All personnel on engagements should maintain independence in mind and in appearance, perform all professional responsibilities with integrity and maintain objectivity in performing their professional responsibilities.
- *Acceptance and continuation of client relationships and engagements* – Policies and procedures should be established for deciding whether to accept or continue a client relationship or specific engagement. These policies and procedures should minimize the risk of associating with a client whose management lacks integrity. The firm should also only undertake engagements that can be completed with professional competence.
- *Human resources* – Policies and procedures should be established to provide the firm with reasonable assurance that all new personnel are qualified to perform their work competently, work is assigned to personnel who have adequate technical training and proficiency, all personnel should participate in continuing professional education and professional development activities that enable them to fulfill their assigned responsibilities, and personnel selected for advancement should have the qualifications necessary for the fulfillment of their assigned responsibilities.
- *Engagement performance* – Policies and procedures should exist to ensure that the work performed by engagement personnel meets applicable professional standards, legal and regulatory requirements, and the firm's standards of quality.
- *Monitoring* – Policies and procedures should exist to ensure that the other quality control elements are being effectively applied.

Quality control standards are established by the Auditing Standards Board for auditors of private companies and by the Public Company Accounting Oversight Board for auditors of public companies.
Terms: Elements of quality controls
Difficulty: Moderate
Objective: LO 2-8
AACSB: Reflective thinking

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14) Listed below are policies or procedures that the Crystal Cove audit firm has in place. For each identified policy or procedure state if it is an auditing standard or a quality control standard.

Audit firm Policy or Procedure	Standards Category
1. Determination on whether to accept or reject a new client. 2. A client evaluation form. 3. All personnel participate in continuing professional education. 4. Conducting the audit with professional skepticism. 5. Answering an independence questionnaire. 6. Determine and apply materiality levels. 7. Audit staff workpapers are reviewed by audit seniors, then managers. 8. Plan work and supervise assistants.	a. auditing standard b. quality control standard

Answer:
1. b
2. b
3. b
4. a
5. b
6. a
7. b
8. a

Terms: Auditing standards and quality control standards
Difficulty: Moderate
Objective: LO 2-8
AACSB: Reflective thinking

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15) The following are definitions of terms that are listed on the right. Match the definition with its associated term. Each term can be used once, more than once or not at all.

Definition	Audit Term
1. an organizational structure where professional services are provided by one or more shareholders 2. the grantor of the right to practice public accounting 3. a report filed to indicate a significant event 4. sets professional standards and rules for members 5. oversees accounting firms who audit public companies 6. an organizational structure where the owners are taxed like a partnership and have limited personal liability 7. a report that is filed when a company wishes to issue new securities 8. the methods used to ensure the firm meets its professional responsibilities to clients and others 9. assists in providing investors with reliable information 10. requires annual inspections of accounting firms auditing more than 100 public companies 11. practice monitoring by a CPA firm for another CPA firm 12. fulfilling duties diligently and carefully 13. requires a registration statement	a. AICPA b. PCAOB c. Securities Exchange Commission d. Form 10-K e. IAASB f. Form S-1 g. due professional care h. limited liability partnership i. professional corporation j. limited liability company k. peer review l. 1933 Securities Act m. 1934 Securities Act n. Form 8-K o. state regulation p. Code of Professional Conduct q. quality control standards r. auditing standards

Answer: 1. i, 2. o, 3. n, 4. a, 5. b, 6. j, 7. f, 8. q, 9. c, 10. b, 11. k, 12. g, 13. l

Terms: AICPA; PCAOB; Securities Exchange Commission; Form S-1; Form 8-K; Due professional care; Professional Corporation; Limited Liability Company; Peer review; 1933 Securities Act; State Regulation; Quality Control Standards
Difficulty: Moderate
Objective: LO 2-1, LO 2-3, LO 2-4, LO 2-5, and LO 2-8
AACSB: Reflective thinking

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