Auditing and Assurance Services 18th edition Arens Test Bank

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Auditing and Assurance Services, 18e **(Arens)**
Chapter 1 The Demand for Audit and Other Assurance Services

1.1 Learning Objective 1-1

1) In the auditing process,
A) the types and amounts of evidence remain constant from audit to audit.
B) the criteria for evaluating information will not vary depending on the information being audited.
C) the audit report communicates the auditor's findings to users.
D) records are gathered by the auditor to determine whether the audited information is stated in accordance with SEC standards.
Answer: C
Terms: Audit process
Difficulty: Moderate
Objective: LO 1-1
AACSB: Reflective thinking

2) Which of the following is considered audit evidence?
A)

Oral statements made by management	Written Communications	Auditor Observations
Y	N	N

B)

Oral statements made by management	Written Communications	Auditor Observations
N	Y	Y

C)

Oral statements made by management	Written Communications	Auditor Observations
Y	Y	Y

D)

Oral statements made by management	Written Communications	Auditor Observations
N	N	Y

Answer: C
Terms: Audit evidence
Difficulty: Easy
Objective: LO 1-1
AACSB: Reflective thinking

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3) Which of the following can be used as a criterion for evaluating information being audited?
A) International Financial Reporting Standards (IFRS)
B) Generally Accepted Accounting Principles (GAAP)
C) Internal Revenue Code (IRC)
D) all of the above
Answer: D
Terms: Criteria by which an auditor evaluates information
Difficulty: Moderate
Objective: LO 1-1
AACSB: Reflective thinking

4) Auditors do **not** provide which of the following?
A) assurance on financial statements
B) assurance on the effectiveness of system of internal controls over financial reporting
C) assurance on corporate sustainability reports
D) absolute assurance on the financial statements including assuming responsibility for them
Answer: D
Terms: Nature of Objectives of Auditing
Difficulty: Moderate
Objective: LO 1-1
AACSB: Reflective thinking

5) The accumulation and evaluation of evidence about information to determine and report on the degree of correspondence between the information and some established criteria is defined as
A) accounting.
B) financial reporting.
C) tax reporting.
D) auditing.
Answer: D
Terms: Definition of auditing
Difficulty: Moderate
Objective: LO 1-1
AACSB: Reflective thinking

6) The criteria by which an auditor evaluates the information under audit may vary with the information being audited.
Answer: TRUE
Terms: Criteria by which an auditor evaluates information
Difficulty: Easy
Objective: LO 1-1
AACSB: Reflective thinking

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7) One criterion used by an external auditor to evaluate published financial statements is known as generally accepted auditing standards.
Answer: FALSE
Terms: Criteria used by external auditor to evaluate published financial statements
Difficulty: Easy
Objective: LO 1-1
AACSB: Reflective thinking

8) Auditors strive to maintain a high level of independence to keep the confidence of users relying on their reports.
Answer: TRUE
Terms: Independence
Difficulty: Easy
Objective: LO 1-1
AACSB: Reflective thinking

9) To perform an audit, there must be information in a verifiable form and some criteria by which the auditor can evaluate the information.
Answer: TRUE
Terms: Independence
Difficulty: Easy
Objective: LO 1-1
AACSB: Reflective thinking

10) An auditor must be competent and have an independent mental attitude.
Answer: TRUE
Terms: Criteria used by external auditor to evaluate published financial statements
Difficulty: Easy
Objective: LO 1-1
AACSB: Reflective thinking

11) Auditors are **not** allowed to audit subjective information like the effectiveness of computer controls or the efficiency of manufacturing-related operations.
Answer: FALSE
Terms: Information and Established Criteria for the Performance of Audits
Difficulty: Moderate
Objective: LO 1-1
AACSB: Reflective thinking

12) In an audit of system of internal controls over financial reporting, the auditor may rely upon the Internal Control - Integrated Framework issued by COSO.
Answer: TRUE
Terms: Information and Established Criteria for the Performance of Audits
Difficulty: Moderate
Objective: LO 1-1
AACSB: Reflective thinking

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13) In circumstances where the auditor is being asked to audit subjective types of information, typically, the auditor and the entities being audited should agree in writing about the criteria being audited after the audit starts.
Answer: FALSE
Terms: Information and Established Criteria for the Performance of Audits
Difficulty: Moderate
Objective: LO 1-1
AACSB: Reflective thinking

14) Evidence is paramount to audit and attestation engagements. List the four basic types of audit evidence.
Answer: The four types of audit and attestation evidence include
1. Electronic and documentary data about transactions
2. Written and electronic communications with outsiders
3. Observations by the auditor
4. Oral testimony of the auditee (client)
Terms: Basic types of audit evidence
Difficulty: Easy
Objective: LO 1-1
AACSB: Reflective thinking

1.2 Learning Objective 1-2

1) Recording, classifying, and summarizing economic events in a logical manner for the purpose of providing financial information for decision making is commonly called
A) finance.
B) auditing.
C) accounting.
D) economics.
Answer: C
Terms: Recording, classifying, and summarizing economic events
Difficulty: Easy
Objective: LO 1-2
AACSB: Reflective thinking

2) An accountant
A) must possess expertise in the accumulation of audit evidence.
B) must decide the number and types of items to test.
C) must have an understanding of the principles and rules that provide the basis for preparing the accounting information.
D) must be a CPA.
Answer: C
Terms: Distinguishes auditors from accountants
Difficulty: Moderate
Objective: LO 1-2
AACSB: Reflective thinking

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3) When auditing accounting data, auditors focus on
A) determining whether recorded information properly reflects the economic events that occurred during the accounting period.
B) determining if fraud has occurred.
C) determining if taxable income has been calculated correctly.
D) analyzing the financial information to be sure that it complies with government requirements.
Answer: A
Terms: Auditing financial accounting data primary concern
Difficulty: Moderate
Objective: LO 1-2
AACSB: Reflective thinking

4) The trait that distinguishes auditors from accountants is the
A) auditor's ability to interpret accounting principles generally accepted in the United States.
B) auditor's education beyond the bachelor's degree.
C) auditor's ability to interpret FASB Statements.
D) auditor's expertise in the accumulation and the interpretation of audit evidence.
Answer: D
Terms: Distinguishes auditors from accountants
Difficulty: Challenging
Objective: LO 1-2
AACSB: Reflective thinking

5) Auditors focus on determining whether recorded information properly reflects the economic events that occurred during the accounting period.
Answer: TRUE
Terms: Roles of accountants and auditors
Difficulty: Easy
Objective: LO 1-2
AACSB: Reflective thinking

6) Both accountants and auditors must possess expertise in the accumulation and interpretation of audit evidence.
Answer: FALSE
Terms: Roles of accountants and auditors
Difficulty: Moderate
Objective: LO 1-2
AACSB: Reflective thinking

7) Accountants are **not** directly responsible for developing a system that ensures the entity's economic events are properly recorded on a timely basis and at a reasonable cost.
Answer: FALSE
Terms: Roles of accountants and auditors
Difficulty: Moderate
Objective: LO 1-2
AACSB: Reflective thinking

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8) Financial statement users do **not** confuse auditing with accounting any longer.
Answer: FALSE
Terms: Roles of accountants and auditors
Difficulty: Moderate
Objective: LO 1-2
AACSB: Reflective thinking

9) Discuss the differences and similarities between the roles of accountants and auditors. What additional expertise must an auditor possess beyond that of an accountant?
Answer: The role of accountants is to record, classify, and summarize economic events in a logical manner for the purpose of providing financial information for decision making. To provide relevant information, accountants must have a thorough understanding of the principles and rules that provide the basis for preparing the accounting information. In addition, accountants must develop a system to ensure that the entity's economic events are properly recorded on a timely basis and at a reasonable cost.

The role of auditors is to determine whether the recorded information prepared by accountants properly reflects the economic events that occurred during the accounting period. Because U.S. or international accounting standards provide the criteria for evaluating whether financial information is properly recorded, auditors must thoroughly understand those accounting standards. In addition to understanding accounting, the auditor must possess expertise in the accumulation and interpretation of audit evidence. It is this expertise that distinguishes auditors from accountants. Determining the proper audit procedures, deciding the number and types of items to test, and evaluating the results are unique to the auditor.
Terms: Roles of accountants and auditors
Difficulty: Moderate
Objective: LO 1-2
AACSB: Reflective thinking

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1.3 Learning Objective 1-3

1) _____ risk reflects the possibility that the information upon which the business decision was made was inaccurate.
A) Client acceptance
B) Information
C) Business
D) Control
Answer: B
Terms: Risk that reflects the possibility that information upon which business risk decision was made
Difficulty: Moderate
Objective: LO 1-3
AACSB: Reflective thinking

2) The possibility that a business may **not** be able to repay a bank loan because of an economic downturn is referred to as
A) materiality risk.
B) information risk.
C) interest rate risk.
D) business risk.
Answer: D
Terms: Business risk
Difficulty: Moderate
Objective: LO 1-3
AACSB: Reflective thinking

3) A bank loan officer is trying to decide whether the bank should make a loan to a particular company. The interest rate the bank will charge the company is determined by many factors. Which of the following factors is influenced by the auditor's report?
A) the risk-free interest rate risk
B) information risk
C) the business risk for/of the customer
D) All of the above are influenced by the auditor's report.
Answer: B
Terms: Interest rate risk/factor influenced by auditor's report
Difficulty: Moderate
Objective: LO 1-3
AACSB: Reflective thinking

4) Auditing can have a significant effect on both information risk and business risk.
Answer: FALSE
Terms: Business risk and information risk
Difficulty: Moderate
Objective: LO 1-3
AACSB: Reflective thinking

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1.4 Learning Objective 1-4

1) A correct relationship among the auditor, the client, and the external users is
A) management of a public company hires the independent auditor.
B) the audit committee of a private company hires the independent auditor.
C) the client provides capital to the external users.
D) the external users can rely upon the auditor's report to reduce information risk.
Answer: D
Terms: Relationships among auditor, client, and external users
Difficulty: Moderate
Objective: LO 1-4
AACSB: Reflective thinking

2) The most common way for users to obtain reliable information is to
A) have an internal audit.
B) have an independent audit.
C) verify all information individually.
D) verify the information with management.
Answer: B
Terms: Obtain reliable information
Difficulty: Moderate
Objective: LO 1-4
AACSB: Reflective thinking

3) External users of the financial statements
A) value the auditor's report because of the auditor's independence from the client.
B) look to the auditor's report as an indication of the statements' reliability.
C) use the audited information on the assumption that it is reasonably complete, accurate, and unbiased.
D) all of the above.
Answer: D
Terms: Relationships among auditor, client, and external users
Difficulty: Easy
Objective: LO 1-4
AACSB: Reflective thinking

4) Which of the following is **not** a cause of information risk?
A) Society, today, is not as complex as it used to be.
B) Remoteness of information.
C) The volume and the complexity of data and exchange transactions.
D) The biases and the motives of the information provider.
Answer: A
Terms: Causes of Information Risk
Difficulty: Easy
Objective: LO 1-4
AACSB: Reflective thinking

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5) Large businesses, especially, have the ability to reduce information risk. Which of the following is **not** a way for a large business to reduce information risk?
A) Paying higher interest rates on loans.
B) The user verifies the information they need by any possible means.
C) The user of information shares information risk with management.
D) Having an independent audit performed of the financial statements.
Answer: A
Terms: Causes of Information Risk
Difficulty: Moderate
Objective: LO 1-4
AACSB: Reflective thinking

6) As society becomes more complex, decision makers are more likely to receive reliable information.
Answer: FALSE
Terms: Reducing information risk
Difficulty: Easy
Objective: LO 1-4
AACSB: Reflective thinking

7) Management is required by GAAP to reduce information risk, even if the costs outweigh the benefits.
Answer: FALSE
Terms: Reducing information risk
Difficulty: Moderate
Objective: LO 1-4
AACSB: Reflective thinking

8) Explain what is meant by information risk, and list the four causes of this risk.
Answer: Information risk reflects the possibility that the information upon which the business risk decision was made was inaccurate. Four causes of information risk are
- remoteness of information,
- biases and motives of the provider,
- voluminous data, and
- complex exchange transactions.

Terms: Information risk definition and causes
Difficulty: Easy
Objective: LO 1-4
AACSB: Reflective thinking

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1.5 Learning Objective 1-5

1) In the audit of historical financial statements, management asserts that the financial statements are fairly stated in accordance with what standards?
A) regulatory accounting principles
B) applicable international accounting standards
C) applicable U.S. accounting standards
D) Both B and C
Answer: D
Terms: Audit of historical financial statements
Difficulty: Easy
Objective: LO 1-5
AACSB: Reflective thinking

2) Any service that requires a CPA firm to issue a report about the reliability of an assertion that is made by another party is a(n)
A) accounting and bookkeeping service.
B) attestation service.
C) assurance service.
D) tax service.
Answer: B
Terms: Assurance services
Difficulty: Easy
Objective: LO 1-5
AACSB: Reflective thinking

3) Three common types of attestation services are
A) audits of historical financial statements, reviews of historical financial statements, and audits of system of internal control over financial reporting.
B) audits of historical financial information, verifications of historical financial information, and attestations regarding system of internal controls.
C) reviews of historical financial information, verifications of future financial information, and attestations regarding system of internal controls.
D) audits of historical financial information, reviews of controls related to investments, and verifications of historical financial information.
Answer: A
Terms: Types of attestation services
Difficulty: Easy
Objective: LO 1-5
AACSB: Reflective thinking

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4) Which of the following services provides the lowest level of assurance on a financial statement?
A) review
B) audit
C) Neither service provides assurance on financial statements.
D) Each service provides the same level of assurance on financial statements.
Answer: A
Terms: Service provides lowest level of assurance on a financial statement
Difficulty: Moderate
Objective: LO 1-5
AACSB: Reflective thinking

5) Which of the following is an accurate statement regarding assurance services?
A) Assurance services must be performed by a CPA.
B) An attestation service is not a type of assurance service.
C) Assurance services improve the quality of information for decision makers.
D) Assurance services can only be performed on financial data.
Answer: C
Terms: Assurance services
Difficulty: Moderate
Objective: LO 1-5
AACSB: Reflective thinking

6) Audits
A) are an assurance service, but not an attestation service.
B) are designed to provide absolute assurance that the financial statements are free of material misstatement.
C) are required for publicly traded companies in the United States.
D) do not require the auditor to express their opinion in a written report.
Answer: C
Terms: Audit assurance
Difficulty: Moderate
Objective: LO 1-5
AACSB: Reflective thinking

7) A high, but **not** absolute, level of assurance is called
A) probable assurance.
B) reasonable assurance.
C) limited assurance.
D) incomplete assurance.
Answer: B
Terms: Reasonable assurance
Difficulty: Easy
Objective: LO 1-5
AACSB: Reflective thinking

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8) Which of the following is an accurate statement regarding the various types of other assurance services?
A) Assurance services must be about the reliability of another party's assertion about compliance with specified criteria.
B) Other assurance services must meet the definition of an attestation service.
C) The primary purpose of a management consulting engagement is to improve the quality of information.
D) The market for other forms of assurance services is open to non-CPA competitors.
Answer: D
Terms: Assurance services
Difficulty: Moderate
Objective: LO 1-5
AACSB: Reflective thinking

9) CPA firms are never allowed to provide bookkeeping services for clients.
Answer: FALSE
Terms: CPA services provided to clients
Difficulty: Moderate
Objective: LO 1-5
AACSB: Reflective thinking

10) Section 404 of the Sarbanes-Oxley Act requires public companies to have an external auditor attest to their system of internal controls over financial reporting.
Answer: TRUE
Terms: Section 404 of the Sarbanes-Oxley Act
Difficulty: Moderate
Objective: LO 1-5
AACSB: Reflective thinking

11) Most public companies' audited financial statements are available on the SEC's EDGAR database.
Answer: TRUE
Terms: Public companies' audited financial statements: SEC's EDGAR database
Difficulty: Moderate
Objective: LO 1-5
AACSB: Reflective thinking

12) The primary purpose of a management consulting engagement is to generate a recommendation(s) to management.
Answer: TRUE
Terms: Nonassurance services provided by CPAs; management consulting
Difficulty: Easy
Objective: LO 1-5
AACSB: Reflective thinking

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13) Audits and some types of attestation services are no longer limited by regulation to licensed CPAs.
Answer: FALSE
Terms: Who can provide audits and certain types of attestation services
Difficulty: Easy
Objective: LO 1-5
AACSB: Reflective thinking

14) Evaluating system of internal controls at third-party service providers, such as cloud computing suppliers, is **not** an attestation type of service which a CPA is allowed to perform today.
Answer: FALSE
Terms: Who can provide other types of attestation services
Difficulty: Easy
Objective: LO 1-5
AACSB: Reflective thinking

15) It is increasingly important for companies to ask their third-party service provider of services, including payroll and other types of transaction processing, for attestation reports covering a review of the effectiveness of system of internal controls in place at the third-party service provider.
Answer: TRUE
Terms: Who can provide other types of attestation services
Difficulty: Easy
Objective: LO 1-5
AACSB: Reflective thinking

16) Two types of attestation services provided by CPA firms are audits and reviews. Discuss the similarities and differences between these two types of attestation services. Which type provides the least assurance?
Answer: In both the review and audit of the historical financial statements, management asserts that the statements are fairly stated in accordance with accounting standards. The CPA provides a lower level of assurance for reviews of financial statements compared to the high level for audits, therefore less evidence is needed. A review is often adequate to meet financial statement users' needs. It can be provided by a CPA firm at a much lower fee than an audit because less evidence is needed.

An audit is the most common assurance service provided by CPA firms. Publicly traded companies in the U.S. are required to have audits under the federal securities acts. Many nonpublic companies have a review to limit audit fees.
Terms: Attestation services; Audits and reviews of historical financial statements
Difficulty: Moderate
Objective: LO 1-5
AACSB: Reflective thinking

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17) What is an audit of system of internal control over financial reporting?
Answer: For an audit of system of internal control over financial reporting, management asserts that system of internal controls have been developed and implemented following well established criteria. Section 404 of the Sarbanes-Oxley Act requires public companies to report management's assessment of the effectiveness of system of internal control. The Act also requires auditors for larger public companies to attest to the effectiveness of system of internal control over financial reporting. This evaluation, which is integrated with the audit of financial statements, increases user confidence about future financial reporting, because effective system of internal controls reduce the likelihood of future misstatements in the financial statements.
Terms: Engagement to attest on system of internal control over financial reporting
Difficulty: Moderate
Objective: LO 1-5
AACSB: Reflective thinking

18) What are the four categories of attestation services?
Answer: The four categories of attestation services include
- Audit of historical financial statements
- Audit of system of internal control over financial reporting
- Review of historical financial statements
- Other attestation services that may be applied to a broad range of subject matters.

Terms: Categories of attestation services
Difficulty: Moderate
Objective: LO 1-5
AACSB: Reflective thinking

19) CPA firms perform numerous services that generally fall outside the scope of assurance services. Give three examples of such services.
Answer: Three specific examples of services performed by CPAs that generally fall outside the scope of assurance services are
- accounting and bookkeeping services
- tax services
- management and consulting services.

Terms: Nonassurance services provided by CPAs
Difficulty: Easy
Objective: LO 1-5
AACSB: Reflective thinking

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1.6 Learning Objective 1-6

1) One objective of an operational audit is to
A) determine whether the financial statements fairly present the entity's operations.
B) determine if the auditee is in compliance with GAAP.
C) make recommendations for improving performance.
D) report on the entity's relative success in attaining profit maximization.
Answer: C
Terms: Objective of operational audit
Difficulty: Moderate
Objective: LO 1-6
AACSB: Reflective thinking

2) An examination of part of an organization's procedures and methods for the purpose of evaluating efficiency and effectiveness is what type of audit?
A) operational audit
B) compliance audit
C) financial statement audit
D) production audit
Answer: A
Terms: Examination of part of an organization's procedures and method to evaluate efficiency and effectiveness
Difficulty: Moderate
Objective: LO 1-6
AACSB: Reflective thinking

3) An audit to determine whether an entity is following specific procedures or rules set down by some higher authority is classified as a(n)
A) audit of financial statements.
B) compliance audit.
C) operational audit.
D) production audit.
Answer: B
Terms: Audit to determine whether entity followed specific procedures or rules
Difficulty: Moderate
Objective: LO 1-6
AACSB: Reflective thinking

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4) Which one of the following is more difficult to evaluate objectively?
A) presentation of financial statements in accordance with generally accepted accounting principles
B) compliance with government regulations
C) efficiency and effectiveness of operations
D) All three of the above are equally difficult.
Answer: C
Terms: Most difficult to evaluate objectively
Difficulty: Challenging
Objective: LO 1-6
AACSB: Reflective thinking

5) Which of the following audits can be regarded as generally being a compliance audit?
A) IRS agents' examinations of taxpayer returns
B) GAO auditor's evaluation of the computer operations of governmental units
C) an internal auditor's review of a company's payroll authorization procedures
D) a CPA firm's audit of a public company
Answer: A
Terms: Compliance audit
Difficulty: Challenging
Objective: LO 1-6
AACSB: Reflective thinking

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6) Which of the following are required to have a written report regarding the assertion of another party?
A)

Financial Statement Audit	Operational Audit	Compliance Audit	Attestation Engagement	Assurance Engagement
Y	Y	Y	Y	Y

B)

Financial Statement Audit	Operational Audit	Compliance Audit	Attestation Engagement	Assurance Engagement
Y	Y	Y	Y	N

C)

Financial Statement Audit	Operational Audit	Compliance Audit	Attestation Engagement	Assurance Engagement
Y	Y	Y	N	N

D)

Financial Statement Audit	Operational Audit	Compliance Audit	Attestation Engagement	Assurance Engagement
N	N	N	Y	Y

Answer: B
Terms: Required to have a written report
Difficulty: Challenging
Objective: LO 1-6
AACSB: Reflective thinking

7) In a financial statement audit, the auditor
A) gathers evidence to determine whether the statements contain material errors or other misstatements.
B) must have a thorough understanding of the entity and its environment.
C) determines whether the financial statements are stated in accordance with specified criteria.
D) all of the above.
Answer: D
Terms: Audit of historical financial statements
Difficulty: Moderate
Objective: LO 1-6
AACSB: Reflective thinking

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8) Which of the following is **not** an example of a compliance audit?
A) The accounting personnel at the Chinese subsidiary following the financial statement preparation procedures prescribed in writing by the corporate controller.
B) Is the company paying the minimum wage rates required by state laws?
C) Determining if a company is meeting the financial covenants of a loan agreement with its lenders.
D) Is the computerized processing of payroll at the Indian subsidiary operating effectively and efficiently?
Answer: D
Terms: Examples of compliance audits
Difficulty: Moderate
Objective: LO 1-6
AACSB: Reflective thinking

9) The primary purpose of a compliance audit is to determine whether the financial statements are prepared in compliance with generally accepted accounting principles.
Answer: FALSE
Terms: Compliance audit
Difficulty: Moderate
Objective: LO 1-6
AACSB: Reflective thinking

10) Results of compliance audits are typically reported to the company's management rather than to a broad spectrum of outside users.
Answer: TRUE
Terms: Compliance audit
Difficulty: Moderate
Objective: LO 1-6
AACSB: Reflective thinking

11) An integrated approach to auditing considers both the risk of misstatements and operating controls intended to prevent misstatements.
Answer: TRUE
Terms: Audit of historical financial statements; integrated approach
Difficulty: Moderate
Objective: LO 1-6
AACSB: Reflective thinking

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12) Discuss the similarities and differences between financial statement audits, operational audits, and compliance audits. Give an example of each type.
Answer: Financial statement audits, operational audits, and compliance audits are similar in that each type of audit involves accumulating and evaluating evidence about information to ascertain and report on the degree of correspondence between the information and established criteria and/or procedures, rules, or regulations. The differences between each type of audit are the information being examined and the criteria used to evaluate the information.

A financial statement audit is conducted to determine whether financial statements are stated in accordance with specified criteria, normally the U.S. or international standards. Auditors not only focus on accounting transactions, but also focus on an integrated approach in which both the risk of misstatements and the operating controls are considered. The auditor must have a thorough understanding of the entity and its environment.

An operational audit evaluates the efficiency and effectiveness of any part of an organization's operating procedures and methods. At completion of an operational audit, management normally expects recommendations for improving operations. In operational auditing, the reviews are not limited to accounting. It is more difficult to objectively evaluate whether the efficiency and effectiveness of operations meets established criteria than it is for compliance and financial statement audits. Also, establishing criteria for evaluating the information in an operational audit is extremely subjective. Thus, operational auditing is more like management consulting than what is usually considered auditing.

A compliance audit is conducted to determine whether the auditee is following specific procedures, rules, or regulations set by some higher authority. Results of compliance audits are typically reported to management, like in the operational audits, rather than to outside users as is done with financial statement audits.

An example of a financial statement audit would be the annual audit of IBM Corporation, in which the external auditors examine IBM's financial statements to determine the degree of correspondence between those financial statements and generally accepted accounting principles. An example of an operational audit would be an internal auditor's evaluation of whether the company's computerized payroll-processing system is operating efficiently and effectively. An example of a compliance audit would be an IRS auditor's examination of an entity's federal tax return to determine the degree of compliance with the Internal Revenue Code.
Terms: Financial statement audits, operational audits and compliance audits
Difficulty: Challenging
Objective: LO 1-6
AACSB: Analytic thinking

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13) To perform an audit, it is necessary for the information to be in a verifiable form and there must be some criteria by which the auditor can evaluate the information. Detail the information and criteria that would be used when
(A) an independent CPA firm audits a company's historical financial statements.
(B) an Internal Revenue Service auditor audits that same company's tax return.
(C) an internal auditor performs an operational audit to evaluate whether the company's computerized payroll processing system is operating efficiently and effectively.
Answer:
(A) The information used by a CPA firm in a financial statement audit is the financial information in the company's financial statements. The most commonly used criteria are applicable U.S. or international accounting standards.
(B) The information used by an IRS auditor is the financial information in the company's federal tax return. The criteria used are the internal revenue code and interpretations.
(C) The information used by an internal auditor when performing an operational audit of the payroll system could include various items such as the number of errors made, costs incurred by the payroll department, and number of payroll records processed each month. The criteria would consist of company standards for departmental efficiency and effectiveness.
Terms: Information and criteria used by CPA firm, Internal Revenue Service auditor, and internal auditor
Difficulty: Moderate
Objective: LO 1-6
AACSB: Reflective thinking

1.7 Learning Objective 1-7

1) Internal auditors
A) must be independent of the entity that employs them.
B) report to the accounting department.
C) are employed by all types of organizations.
D) must be CPAs.
Answer: C
Terms: Internal audit
Difficulty: Moderate
Objective: LO 1-7
AACSB: Reflective thinking

2) Which type of auditor audits the financial information prepared by various federal government agencies before it is submitted to Congress?
A) internal auditor
B) revenue agent
C) independent auditor
D) GAO auditor
Answer: D
Terms: Types of auditors
Difficulty: Easy
Objective: LO 1-7
AACSB: Reflective thinking

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3) The primary role of the United States General Accounting Office is the enforcement of the Federal tax laws as defined by Congress and interpreted by the courts.
Answer: FALSE
Terms: Primary role of United States General Accounting Office
Difficulty: Moderate
Objective: LO 1-7
AACSB: Reflective thinking

4) CPA firms are often called and thought of by outsiders as external auditors, independent auditors, or internal auditors.
Answer: FALSE
Terms: Primary role of CPA firms
Difficulty: Easy
Objective: LO 1-7
AACSB: Reflective thinking

5) Compliance is a secondary objective of audits performed by the GAO of the financial information prepared by the various Federal government agencies before that information is submitted to Congress.
Answer: FALSE
Terms: Primary role of the GAO
Difficulty: Moderate
Objective: LO 1-7
AACSB: Reflective thinking

6) The GAO reports to the Public Company Accounting Oversight Board, which reports to the Securities and Exchange Commission.
Answer: FALSE
Terms: GAO reports to and is responsible only to Congress
Difficulty: Moderate
Objective: LO 1-7
AACSB: Reflective thinking

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7) Match the engagement described to the (A) type of audit and (B) auditor that would most likely perform the engagement. Each engagement will have an answer from List-A and List-B. An answer can be used once, more than once, or **not** at all.

List A - Type of Audit:	**List B - Type of Auditor:**
a. Financial Statement b. Compliance c. Operational	d. Internal e. External f. Government g. IRS

Engagement:
1. Evaluate a company's payroll processing for economy of scale.
2. Evaluate/determine if bank covenants are being met.
3. Evaluate financial statements that are to be submitted to a bank.
4. Evaluate the promptness of materials inspection in a manufacturer's receiving department.
5. Determine if Medicare reimbursements are in accordance with the Healthcare Financing Administration (HCFA).
6. Determine if the tax return of a multinational corporation is in accordance with the tax code.
7. Determine if a public school is properly applying their reimbursement for the payment-in-kind program.
8. Determine the effectiveness of a Department of Defense project.

Answer:
1. c, d
2. b, d
3. a, e
4. c, d
5. b, f
6. b, g
7. b, e
8. c, f

Terms: Financial statement audit; Compliance audit; Operational audit; Types of auditors
Difficulty: Challenging
Objective: LO 1-7
AACSB: Analytic thinking

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8) Discuss the similarities and differences between the roles of independent auditors, GAO auditors, internal revenue agents, and internal auditors.
Answer: The roles of all four types of auditors are similar in that they involve the accumulation and evaluation of evidence about information to ascertain and report on the degree of correspondence between the information and established criteria. The differences in their roles center around the information audited and the criteria used to evaluate that information. Independent auditors primarily audit companies' financial statements. GAO auditors' primary responsibility is to perform the audit function for Congress. IRS auditors are responsible for the enforcement of federal tax laws. Internal auditors primarily perform operational and compliance audits for their employing company.
Terms: Roles of independent auditors, GAO auditors, internal revenue agents and internal auditors
Difficulty: Moderate
Objective: LO 1-7
AACSB: Reflective thinking

1.8 Learning Objective 1-8

1) The three requirements for becoming a CPA include all but which of the following?
A) uniform CPA examination requirement
B) education requirements
C) character requirements
D) experience requirement
Answer: C
Terms: Requirements for becoming a CPA
Difficulty: Moderate
Objective: LO 1-8
AACSB: Reflective thinking

2) The use of the Certified Public Accountant title is regulated by
A) the federal government.
B) state law through the licensing departments of each state.
C) the American Institute of Certified Public Accountants through the licensing departments of the tax and auditing committees.
D) the Securities and Exchange Commission.
Answer: B
Terms: Certified Public Accountant title
Difficulty: Moderate
Objective: LO 1-8
AACSB: Reflective thinking

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3) The AICPA, working together with NASBA, recently completed a significant revision of the CPA examination effective January 2024, referred to as the CPA Evolution. The 'Core' content of this revised licensure process is focused on each of the following topics that should be familiar to newly licensed CPAs **except**
A) information systems and controls.
B) accounting.
C) audit and attestation.
D) tax.
Answer: A
Terms: Structure of the CPA Examination
Difficulty: Moderate
Objective: LO 1-8
AACSB: Reflective thinking

4) The "Disciplines" content of the revised licensure process focuses on one of three areas to be selected by the individual seeking licensure. Which of the following is **not** one of these areas?
A) Audit and Attestation
B) Business Analysis and Reporting
C) Tax Compliance and Planning
D) Information Systems and Controls
Answer: A
Terms: Structure of the CPA Examination
Difficulty: Moderate
Objective: LO 1-8
AACSB: Reflective thinking

5) List and discuss the three primary requirements to become a CPA.
Answer: The three primary requirements for becoming a CPA are:
• *Educational requirement*. Normally, an undergraduate degree or a graduate degree with a major in accounting, including a minimum number of accounting credits is required. Most states now require 150 semester hours (225 quarter hours) for licensure as a CPA. Some states require fewer credits before taking the examination, but require 150 semester credits before receiving the CPA certificate.
• *Uniform CPA examination requirement*. This is presently a four-part, computer-based examination with components on auditing and attestation, financial accounting and reporting, regulation, and business environment and concepts. Exam covers content that a newly licensed CPA must possess. Some states also require a separate ethics requirement. Significant changes to the CPA exam incorporating a "core" plus "discipline" approach will be effective January 2024.
• *Experience requirement*. The experience requirement varies from state to state with some states requiring no experience, while other states require up to two years of audit experience. Some states include experience working for governmental units or in industry, including internal auditing.
Terms: Primary requirements to become CPA
Difficulty: Easy
Objective: LO 1-8
AACSB: Reflective thinking

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