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Chapter 2

Professionalism and Professional Responsibilities

Question Type: True or False

1. The cornerstone of the public accounting profession is evidenced by the work done in the public interest by CPAs.

   A. True

   B. False

   Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA BB: Governance Perspective, AACSB: Ethics, Learning Objective: LO2.1, Solution: The cornerstone of the public accounting profession is recognized in the public interest in the work done by CPAs.

2. Both licensed tax preparers and CPA professionals have the right to sign tax returns.

   A. True

   B. False

   Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA BB: Governance Perspective, AACSB: Ethics, Learning Objective: LO2.1, Solution: The right to sign tax returns as a tax preparer is granted to both licensed tax preparers and licensed CPA Professionals.

3. A professional concerned for the public interest (CPI) is defined by their professional line of work or occupation.

   A. True

   B. False

   Answer: B, Taxonomy: Knowledge, Difficulty: Easy, AICPA PC: Professional Behavior, AACSB: Ethics, Learning Objective: LO2.1, Solution: In the context of an EC Professional, the profession is usually defined by the line of work or occupation.

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4. The rules of AICPA Code of Professional Conduct are applicable to members in public practice only.

A. True

B. False

Answer: B, Taxonomy: Knowledge, Difficulty: Easy, AICPA BB: Governance Perspective, AACSB: Ethics, Learning Objective: LO2.2, Solution: The rules of AICPA Code of Professional Conduct are applicable to members in public practice, those in business, and others.

5. The rules of conduct of the AICPA Code of Professional Conduct establish minimum standards of ethical conduct in the performance of professional services.

A. True

B. False

Answer: B, Taxonomy: Knowledge, Difficulty: Easy, AICPA BB: Governance Perspective, AACSB: Ethics, Learning Objective: LO2.2, Solution: The rules of conduct of the AICPA Code of Professional Conduct establish minimum standards of **acceptable** conduct in the performance of professional services.

6. CPAs must obtain their license from State Boards of Accountancy.

A. True

B. False

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA BB: Governance Perspective, AACSB: Ethics, Learning Objective: LO2.2, Solution: CPAs must obtain their license from State Boards of Accountancy, irrespective of whether they are members of the AICPA or not.

7. An adverse interest threat is a threat that a CPA will not act with objectivity because the CPA's interests are opposed to the client's interests.

A. True

B. False

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA PC: Decision Making, AACSB: Ethics, Learning Objective: LO2.3, Solution: An adverse interest threat is a threat that a CPA will not act with objectivity because the CPA's interests are opposed to the client's interests.

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8. Of the three basic types of safeguards, the first is the safeguards implemented by a client.

A. True

B. False

Answer: B, Taxonomy: Knowledge, Difficulty: Easy, AICPA PC: Decision Making, AACSB: Ethics, Learning Objective: LO2.3, Solution: In three basic types of safeguards, the first is safeguards created by the profession (e.g., the safeguards suggested in the rules of the code of conduct, legislation, or regulation).

9. CPAs should evaluate identified threats individually only.

A. True

B. False

Answer: B, Taxonomy: Knowledge, Difficulty: Easy, AICPA PC: Decision Making, AACSB: Ethics, Learning Objective: LO2.3, Solution: CPAs should evaluate identified threats both individually and in aggregate.

10. According to the integrity and objectivity rule, a member need not be free of conflict of interest.

A. True

B. False

Answer: B, Taxonomy: Knowledge, Difficulty: Easy, AICPA PC: Decision Making, AACSB: Ethics, Learning Objective: LO2.4, Solution: According to the integrity and objectivity rule, a member should be free of conflict of interest.

11. The rule on integrity and objectivity applies to all services performed by CPAs.

A. True

B. False

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA PC: Decision Making, AACSB: Ethics, Learning Objective: LO2.4, Solution: The rule on integrity and objectivity applies to all services performed by CPAs, including tax, audit, bookkeeping, and consulting services.

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12. Independence in appearance is avoiding potential conflicts of interest that can be observed by others.

A. True

B. False

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA PC: Decision Making, AACSB: Ethics, Learning Objective: LO2.5, Solution: Independence in appearance is avoiding potential conflicts of interest that can be observed by others.

13. Partners and managers with consultation, oversight, or review responsibilities related to the engagement are covered members.

A. True

B. False

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA PC: Professional Behavior, AACSB: Communication, Learning Objective: LO2.5, Solution: Partners and managers with consultation, oversight, or review responsibilities related to the engagement are covered members.

14. A covered member can be a trustee of a trust or an executor of an estate who invests in an attest client.

A. True

B. False

Answer: B, Taxonomy: Knowledge, Difficulty: Easy, AICPA PC: Decision Making, AACSB: Ethics, Learning Objective: LO2.5, Solution: A covered member cannot be a trustee of a trust or an executor of an estate who invests in an attest client.

15. The general standards of the AICPA Code of Professional Conduct can help study and understand the ethical behavior of CPAs.

A. True

B. False

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA FC: Reporting, AACSB: Ethics, Learning Objective: LO2.6, Solution: The general standards of the AICPA Code of Professional Conduct can help study and understand the ethical behavior of CPAs.

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16. The general standards of the AICPA Code of Professional Conduct apply only to CPAs performing attest engagements.

A. True

B. False

Answer: B, Taxonomy: Knowledge, Difficulty: Easy, AICPA FC: Reporting, AACSB: Ethics, Learning Objective: LO2.6, Solution: The general standards of the AICPA Code of Professional Conduct apply to all CPAs performing public accounting services.

17. If a CPA is unable to gain sufficient competence, a CPA should suggest the engagement of a competent person to perform the needed professional service.

A. True

B. False

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA FC: Reporting, AACSB: Ethics, Learning Objective: LO2.6, Solution: If a CPA is unable to gain sufficient competence, a CPA should suggest the engagement of a competent person to perform the needed professional service.

18. It is important for a client who is considering purchasing accounting software to know that their CPA is being paid a commission if the business purchases the software.

A. True

B. False

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA BB: Global and Industry Perspectives, AACSB: Technology, Learning Objective: LO2.7, Solution: It is important for a client considering purchasing accounting software to know that the CPA is being paid a commission if the business purchases the software.

19. Rule 1.500 of the AICPA pertains to confidential information.

A. True

B. False

Answer: B, Taxonomy: Knowledge, Difficulty: Easy, AICPA BB: Governance Perspective, AACSB: Ethics, Learning Objective: LO2.7, Solution: Rule 1.700 of the AICPA pertains to confidential information.

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20. The auditor generally uses the due care defense in breach of contract suits involving negligence.

A. True

B. False

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA PC: Decision Making, AACSB: Ethics, Learning Objective: LO2.8 Evaluate an auditors' legal liability under common law., Solution: The auditor generally uses the due care defense in breach of contract suits involving negligence.

21. In the case of an embezzlement, the bonding company can bring suits against the CPA for failing to discover the fraud.

A. True

B. False

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA PC: Decision Making, AACSB: Ethics, Learning Objective: LO2.8 Evaluate an auditor's legal liability under common law., Solution: When an embezzlement occurs, the bonding company reimburses the insured (the client) for its losses. Then, under the right of subrogation to the insured's contractual claim, the bonding company can bring suits against the CPA for failing to discover the fraud.

22. A due care defense is a primary defense against tort actions just as it constitutes a contributory negligence defense.

A. True

B. False

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA BB: Governance Perspective, AACSB: Ethics, Learning Objective: LO2.8 Evaluate an auditor's legal liability under common law., Solution: A due care defense is a primary defense against tort actions, as it is for contributory negligence.

23. In legal defense, the defendant must establish that the plaintiff's loss resulted in whole or in part from causes other than the false or misleading statements.

A. True

B. False

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA BB: Governance Perspective, AACSB: Ethics, Learning Objective: LO2.9, Solution: In defense, the defendant must establish that the plaintiff's loss resulted in whole or in part from causes other than the false or misleading statements.

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24. The defendant in a Section 18 suit must prove that he or she had knowledge of the false or misleading statement.

A. True

B. False

Answer: B, Taxonomy: Knowledge, Difficulty: Easy, AICPA BB: Governance Perspective, AACSB: Ethics, Learning Objective: LO2.9, Solution: The defendant (the auditor) in a Section 18 suit must prove that he or she had no knowledge of the false or misleading statement.

25. Only smaller class action lawsuits, which involve less than 50 people, can still be filed in a state court.

A. True

B. False

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA BB: Governance Perspective, AACSB: Ethics, Learning Objective: LO2.9, Solution: Only smaller class action lawsuits, which involve less than 50 people, can still be filed in a state court.

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Question Type: Multiple choice

26. In defining a profession or professional, one common characteristic is _____.

A. concern for the public interest
B. self-promotion
C. effective marketing skills
D. effective communication skills

Answer: A, Taxonomy: Comprehensive, Difficulty: Easy, AICPA PC: Professional Behavior, AACSB: Ethics, Learning Objective: LO2.1, Solution: A profession can be defined by a concern for the public interest.

27. Which group licenses CPAs?

A. The FASB
B. The SEC
C. The AICPA
D. The State Boards of Accountancy

Answer: D, Taxonomy: Knowledge, Difficulty: Easy, AICPA PC: Professional Behavior, AACSB: Ethics, Learning Objective: LO2.1, Solution: The State Boards of Accountancy license CPAs.

28. What must CPAs complete to achieve licensure?

A. An application, required education, and pass the CPA Exam.
B. Required education, pass the CPA Exam, and requisite experience requirement.
C. An application, finger prints, and pass the CPA Exam.
D. A background check, drug test, and pass the CPA Exam.

Answer B, Taxonomy: Comprehensive, Difficulty: Easy, AICPA PC: Professional Behavior, AACSB: Ethics, Learning Objective: LO2.1, Solution: CPAs must have the required education, pass the exam, and possess the requisite experience.

29. There was public concern about professional auditing in the late 1990s and the 21st century when about _____ of all public companies had to restate their earnings.

A. 8 percent

B. 2 percent

C. 15 percent

D. 30 percent

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Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA BB: Governance Perspective, AACSB: Ethics, Learning Objective: LO2.1, Solution: During the late 1990s and the first few years of the 21st century, auditors failed to find many material misstatements on a timely basis, and many times management had to restate earnings due to material misstatements. There was public concern about the quality of professional auditing services when about 8% of all public companies had to restate their earnings in the late 1990s and early 21st Century.

30. According to Chapter 2 regarding professionalism and professional responsibilities, CPI stands for _____.

A. commitment to professional integrity
B. concern for public interest
C. continuing professional interest
D. classified professional intelligence

Answer: B, Taxonomy: Knowledge, Difficulty: Easy, AICPA PC: Professional Behavior, AACSB: Ethics, Learning Objective: LO2.1, Solution: CPI stands for concern for public interest.

31. Interpretations provide additional guidance regarding the scope and applicability of the _____.

A. rules of conduct

B. standards

C. conceptual framework

D. principles

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA BB: Global and Industry Perspectives, AACSB: Ethics, Learning Objective: LO2.2, Solution: Interpretations provide additional guidance regarding the scope and applicability of the rules of conduct.

32. Which of the following components of the AICPA are enforceable?

A. Rules of conduct

B. Principles

C. Interpretations

D. None of the options is correct

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Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA BB: Governance Perspective, AACSB: Ethics, Learning Objective: LO2.2, Solution: The rules of conduct of the AICPA are enforceable, but not the principles or interpretations.

33. The structure of the AICPA _____ includes four major sections: preface, rules for members in public practice, rules for members in business, and rules for other members.

A. Code of Professional Conduct

B. Conceptual Framework

C. Independence Rules

D. Rules of Conduct

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA BB: Governance Perspective, AACSB: Ethics, Learning Objective: LO2.2, Solution: The AICPA Code of Professional Conduct is organized in four major sections: 1) a preface; 2) rules for members in public practice; 3) rules for members in business; and 4) rules for other members.

34. Which of the following provides guidance to all members of the AICPA with respect to performance of their professional responsibilities?

A. Code of Professional Conduct

B. Rules of Conduct

C. Principles

D. Interpretations

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA BB: Governance Perspective, AACSB: Ethics, Learning Objective: LO2.2, Solution: The AICPA Code of Professional Conduct, which includes principles, rules, and interpretations, provides guidance to all members of the AICPA with respect to performance of their professional responsibilities.

35. Which component of the AICPA's Code of Professional Conduct expresses the basic tenets of ethical conduct and provides the framework for the rules that govern the performance of a member's professional responsibilities?

A. Principles

B. Rules of Conduct

C. Interpretations

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D. General standards

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA PC: Professional Behavior, AACSB: Ethics, Learning Objective: LO2.2, Solution: The principles express the basic tenets of ethical conduct and provide the framework for the rules.

36. Which component of the AICPA's Code of Professional Conduct establishes minimum standards of acceptable conduct in the performance of professional services?

A. Principles

B. Rules of Conduct

C. Interpretations

D. General standards

Answer: B, Taxonomy: Knowledge, Difficulty: Easy, AICPA PC: Professional Behavior, AACSB: Ethics, Learning Objective: LO2.2, Solution: The Rules of Conduct establish minimum standards of acceptable conduct.

37. Which component of the AICPA's Code of Professional Conduct provides additional guidance regarding the scope and applicability of the rules of conduct?

A. Principles

B. Rules of Conduct

C. Interpretations

D. General standards

Answer: C, Taxonomy: Knowledge, Difficulty: Easy, AICPA PC: Professional Behavior, AACSB: Ethics, Learning Objective: LO2.2, Solution: The interpretations provide additional guidance.

38. The AICPA Code of Professional Conduct can be found online and is organized in four sections. Which section is first?

A. Part I on ethical rules.

B. Preface applicable to all members.

C. Introduction to the History of the Code of Conduct.

D. Foreword about AICPA membership.

Answer: B, Taxonomy: Knowledge, Difficulty: Hard, AICPA PC: Professional Behavior, AACSB: Ethics, Learning Objective: LO2.2, Solution: The preface is the first section of The Code.

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39. In the online version of the AICPA Code of Professional Conduct, what are used to make it easy to find related topics?

A. Summaries

B. A series of hyperlinks

C. Outlines

D. Interpretations

Answer: B, Taxonomy: Knowledge, Difficulty: Hard, AICPA PC: Professional Behavior, AACSB: Ethics, Learning Objective: LO2.2, Solution: Hyperlinks are used in the online version of The Code to make it easy to find related topics.

40. Which section of the AICPA Code of Professional Conduct includes ethical rules for members in business?

A. Part I

B. Part II

C. Part III

D. Some other section

Answer: B, Taxonomy: Knowledge, Difficulty: Hard, AICPA PC: Professional Behavior, AACSB: Ethics, Learning Objective: LO2.2, Solution: Part II includes ethical rules for members in business.

41. Which section of the AICPA Code of Professional Conduct includes ethical rules for other members, like non-CPA members of the AICPA?

A. Part I

B. Part II

C. Part III

D. Some other section

Answer C, Taxonomy: Knowledge, Difficulty: Hard, AICPA PC: Professional Behavior, AACSB: Ethics, Learning Objective: LO2.2, Solution: Part III of The Code includes ethical rules for other members.

42. Which section of the AICPA Code of Professional Conduct includes ethical rules for members in public practice?

A. Part I

B. Part II

C. Part III

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D. Some other section

Answer A, Taxonomy: Knowledge, Difficulty: Hard, AICPA PC: Professional Behavior, AACSB: Ethics, Learning Objective: LO2.2, Solution: Part I includes ethical rules for members in public practice.

43. Which component of the AICPA's Code of Professional Conduct is enforceable wherein members must be prepared to justify departures?

A. Principles

B. Rules of Conduct

C. Commitments

D. Standards

Answer: B, Taxonomy: Comprehension, Difficulty: Easy, AICPA PC: Professional Behavior, AACSB: Ethics, Learning Objective: LO2.2, Solution: The rules are enforceable wherein members must be prepared to justify departures.

44. Which component of the AICPA's Code of Professional Conduct requires that a member who departs from it shall have the burden of justifying the departure in a disciplinary hearing?

A. Principles

B. Standards

C. Commitments

D. Interpretations

Answer D, Taxonomy: Comprehension, Difficulty: Easy, AICPA PC: Professional Behavior, AACSB: Ethics, Learning Objective: LO2.2, Solution: A member who departs from the interpretations shall have the burden of justifying the departure.

45. The AICPA is an accounting organization representing the profession and membership is _____.

A. non-voluntary

B. voluntary

C. free

D. required

Answer: B, Taxonomy: Knowledge, Difficulty: Easy, AICPA PC: Professional Behavior, AACSB: Ethics, Learning Objective: LO2.2, Solution: Membership in the AICPA is voluntary.

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46. State Boards of Accountancy typically _____.

A. work separately from the AICPA on many professional issues

B. work together with the AICPA on many professional issues

C. have separate codes of conduct from the AICPA

D. leave the task of licensure to the AICPA

Answer: B, Taxonomy: Knowledge, Difficulty: Easy, AICPA PC: Professional Behavior, AACSB: Ethics, Learning Objective: LO2.2, Solution: State boards typically work together with the AICPA on many professional issues.

47. When you pass the CPA exam and then seek licensure, you would apply to _____.

A. AICPA

B. your university

C. NASBA

D. your State Board of Accountancy

Answer: D, Taxonomy: Knowledge, Difficulty: Easy, AICPA PC: Professional Behavior, AACSB: Ethics, Learning Objective: LO2.2, Solution: You would apply to the State Board of Accountancy.

48. What is a key element that best separates recognized professions from other occupations?

A. Large application fees

B. A commitment to ethical behavior

C. Certifications

D. Specific schooling requirements

Answer: B, Taxonomy: Comprehension, Difficulty: Easy, AICPA PC: Professional Behavior, AACSB: Ethics, Learning Objective: LO2.2, Solution: A commitment to ethical behavior separates recognized professions from other occupations.

49. Although codes of ethics may be designed in part to encourage ideal behavior, they must also be _____.

A. practical and enforceable

B. idealistic and above the law

C. easy to remember and basic

D. balanced and confidential

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Answer: A, Taxonomy: Comprehension, Difficulty: Hard, AICPA PC: Professional Behavior, AACSB: Ethics, Learning Objective: LO2.2, Solution: Codes of ethics must also be practical and enforceable.

50. If a CFO of a company is dealing with an ethical situation, which section of the AICPA's Code of Professional Ethics might he/she refer?

A. Part I

B. Part II

C. Part III

D. Some other section

Answer: B, Taxonomy: Knowledge, Difficulty: Hard, AICPA PC: Professional Behavior, AACSB: Ethics, Learning Objective: LO2.2, Solution: He/she should refer to Part II as a member in business.

51. If a public practice CPA firm is concerned about the ethical nature of the firm's advertising, which section of the AICPA's Code of Professional Ethics would provide guidance?

A. Part I

B. Part II

C. Part III

D. Some other section

Answer: A, Taxonomy: Knowledge, Difficulty: Hard, AICPA PC: Professional Behavior, AACSB: Ethics, Learning Objective: LO2.2, Solution: Part I would provide guidance to members in public practice.

52. To be meaningful, a code of ethics must strike a balance between being _____.

A. above the law but below the ideal

B. below the law but above the ideal

C. above the law but below practical

D. below the law but above practical

Answer: A, Taxonomy: Comprehension, Difficulty: Hard, AICPA PC: Professional Behavior, AACSB: Ethics, Learning Objective: LO2.2, Solution: A code of ethics should be above the law but below the ideal.

53. In which section of the AICPA Code of Professional Conduct could you find the definitions to concepts mentioned in the Code?

A. Part I

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B. Part II

C. Part III

D. Preface applicable to all members

Answer: D, Taxonomy: Knowledge, Difficulty: Hard, AICPA PC: Professional Behavior, AACSB: Ethics, Learning Objective: LO2.2, Solution: Definitions are located in the preface.

54. Which of the following is the threat that, due to a long or close relationship with a client, a CPA will become too sympathetic to the client's interests or too accepting of the client's work or product?

A. Familiarity threat

B. Adverse interest threat

C. Advocacy threat

D. Self-review threat

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA PC: Decision Making, AACSB: Ethics, Learning Objective: LO2.3, Solution: A familiarity threat is the threat that, due to a long or close relationship with a client, a CPA will become too sympathetic to the client's interests or too accepting of the client's work or product.

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55. An advocacy threat is the threat that a CPA will _____.

A. promote a client's interests

B. take on the role of client management

C. become too sympathetic to a client's interests

D. not act with objectivity

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA PC: Decision Making, AACSB: Ethics, Learning Objective: LO2.3, Solution: An advocacy threat is the threat that a CPA will promote a client's interests.

56. A/an _____ threat exists if a CPA performs bookkeeping services for a private company client and that work needs to be evaluated by the same firm in the course of an attest engagement.

A. self-review

B. undue influence

C. adverse interest

D. advocacy

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA PC: Decision Making, AACSB: Ethics, Learning Objective: LO2.3, Solution: A self-review threat exists if a CPA performs bookkeeping services for a private company client and that work needs to be evaluated by the same firm in the course of an attest engagement.

57. If a CPA is unable to implement effective safeguards, what should the CPA do?

A. Decline the engagement.

B. Proceed with the professional service.

C. Document the identified threats.

D. Evaluate the significance of the threat.

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA PC: Decision Making, AACSB: Ethics, Learning Objective: LO2.3, Solution: If a CPA is unable to implement effective safeguards, the CPA should decline or terminate the engagement.

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58. Rules of Professional Conduct and related interpretations are specifically written for _____.

A. FASB members
B. Accountants in public practice
C. Accountants in private practice
D. SEC personnel

Answer: B, Taxonomy: Knowledge, Difficulty: Easy, AICPA PC: Professional Behavior, AACSB: Ethics, Learning Objective: LO2.3, Solution: The rules of professional conduct and related interpretations are specifically written for those in public practice.

59. In the absence of a rule or an interpretation, a CPA could use which of the following to apply to the accounting for a certain situation?

A. The SEC rulings
B. The Conceptual Framework
C. An auditing textbook
D. The IRS Code

Answer: B LO 3, Taxonomy: Knowledge, Difficulty: Easy, AICPA PC: Professional Behavior, AACSB: Ethics, Learning Objective: LO2.3, Solution: The rules in the AICPA Code of Professional Conduct and related interpretations seek to address many situations for members in public practice. However, the rules and interpretations cannot address every possible relationship or circumstance that might arise. Thus, in the absence of a rule or an interpretation, a CPA should use the Conceptual Framework to evaluate what to do.

60. A threat that is due to a long or close relationship is a(n) _____.

A. familiarity threat
B. management participation threat
C. self-interest threat
D. self-review threat

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA PC: Professional Behavior, AACSB: Ethics, Learning Objective: LO2.3, Solution: A familiarity threat is due to a long or close relationship.

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61. A threat that a CPA will take on the role of client decision making or assume associated responsibilities is a(n) _____.

A. familiarity threat
B. management participation threat
C. self-interest threat
D. self-review threat

Answer: B, Taxonomy: Knowledge, Difficulty: Easy, AICPA PC: Professional Behavior, AACSB: Ethics, Learning Objective: LO2.3, Solution: A management participation threat is the threat that a CPA will take on the role of client decisions or assume associated responsibilities.

62. A threat that a CPA will promote a client's interests or position to the point that his or her objectivity is compromised is a(n) _____.

A. familiarity threat
B. advocacy threat
C. self-interest threat
D. self-review threat

Answer: B, Taxonomy: Knowledge, Difficulty: Easy, AICPA PC: Professional Behavior, AACSB: Ethics, Learning Objective: LO2.3, Solution: The advocacy threat is the threat that a CPA will promote a client's interests to the point that his or her objectivity is compromised.

63. A threat that a CPA will not act with objectivity because the CPA's interests are opposed to the client's interests is a(n) _____.

A. familiarity threat
B. advocacy threat
C. self-interest threat
D. adverse Interest Threat

Answer: D, Taxonomy: Knowledge, Difficulty: Easy, AICPA PC: Professional Behavior, AACSB: Ethics, Learning Objective: LO2.3, Solution: The adverse interest threat is the threat that a CPA will not act with objectivity because the CPA's interests are opposed to the client's interests.

64. A threat that a CPA could benefit, financially or otherwise, from an interest in, or relationship with, a client or persons associated with the client is a(n) _____.

A. familiarity threat
B. management participation threat
C. self-interest threat
D. self-review threat

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Answer: C, Taxonomy: Knowledge, Difficulty: Easy, AICPA PC: Professional Behavior, AACSB: Ethics, Learning Objective: LO2.3, Solution: The self-interest threat is the threat that a CPA could benefit from an interest in or relationship with a client or persons associated with the client.

65. A threat that a CPA will not appropriately evaluate the results of a previous judgment made by, or service performed by, an individual in the CPA's firm is a(n) _____.

A. familiarity threat
B. advocacy threat
C. self-interest threat
D. self-review threat

Answer: D, Taxonomy: Knowledge, Difficulty: Easy, AICPA PC: Professional Behavior, AACSB: Ethics, Learning Objective: LO2.3, Solution: The self-review threat is the threat that a CPA will not appropriately evaluate the results of a previous judgment made by, or service performed by, and individual in the CPA's firm.

66. A threat that a CPA will allow a third party to coerce his/her judgment about a client is known as a(n):

A. familiarity threat
B. advocacy threat
C. self-interest threat
D. undue influence threat

Answer: D, Taxonomy: Knowledge, Difficulty: Easy, AICPA PC: Professional Behavior, AACSB: Ethics, Learning Objective: LO2.3, Solution: The undue influence threat is the threat that a CPA will allow a third party to coerce his/her judgment about a client.

67. The first step in the process to assist the CPA in making an ethical judgment is _____.

A. identify threats to compliance with rules
B. evaluate the significance of the threat
C. identify and apply safeguards
D. evaluate the effectiveness of the safeguards

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA PC: Professional Behavior, AACSB: Ethics, Learning Objective: LO2.3, Solution: The first step is to identify threats.

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68. The last step in the process to assist the CPA in making an ethical judgment is _____.

A. document the threats and safeguards
B. evaluate the significance of the threat
C. identify and apply safeguards
D. evaluate the effectiveness of the safeguards

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA PC: Professional Behavior, AACSB: Ethics, Learning Objective: LO2.3, Solution: The last step is to document the threats and safeguards.

69. The second step in the process to assist the CPA in making an ethical judgment is _____.

A. identify threats to compliance with rules
B. evaluate the significance of the threat
C. identify and apply safeguards
D. evaluate the effectiveness of the safeguards

Answer: B, Taxonomy: Knowledge, Difficulty: Easy, AICPA PC: Professional Behavior, AACSB: Ethics, Learning Objective: LO2.3, Solution: The second step is to evaluate the significance of the threat.

70. The third step in the process to assist the CPA in making an ethical judgment is _____.

A. identify threats to compliance with rules
B. evaluate the significance of the threat
C. identify and apply safeguards
D. evaluate the effectiveness of the safeguards

Answer: C, Taxonomy: Knowledge, Difficulty: Easy, AICPA PC: Professional Behavior, AACSB: Ethics, Learning Objective: LO2.3, Solution: The third step is to identify and apply safeguards.

71. The fourth step in the process to assist the CPA in making an ethical judgment is _____.

A. identify threats to compliance with rules
B. evaluate the significance of the threat
C. identify and apply safeguards
D. evaluate the effectiveness of the safeguards

Answer: D, Taxonomy: Knowledge, Difficulty: Easy, AICPA PC: Professional Behavior, AACSB: Ethics, Learning Objective: LO2.3, Solution: The fourth step is to evaluate the effectiveness of the safeguards.

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72. A CPA should judge his or her ethical conduct from the perspective of a _____.

A. reasonable and informed third party
B. circuit court judge
C. high school graduate
D. IRS agent

Answer: A, Taxonomy: Comprehension, Difficulty: Easy, AICPA PC: Professional Behavior, AACSB: Ethics, Learning Objective: LO2.3, Solution: A CPA should judge his or her ethical conduct from the perspective of a reasonable and informed third party.

73. What are the three types of safeguards against threats to a CPA's compliance with the ethical rules of the profession?

A. Independence, legal liability, and accounting standards
B. Self-control, internal compass, and future goals
C. Safeguard of regulation, client implemented controls, and CPA firm policies
D. Safeguard of standards, Acts of Congress, certification

Answer: C, Taxonomy: Comprehension, Difficulty: Easy, AICPA PC: Professional Behavior, AACSB: Ethics, Learning Objective: LO2.3, Solution: The three types of safeguards are regulation, client implemented controls, and CPA firm policies.

74. Which of the following statements is true?

A. It is possible for a CPA firm to rely solely on safeguards implemented by the client to eliminate or reduce significant threats to an acceptable level.
B. There are five basic safeguards to assist CPAs with threats to compliance with the accounting profession's ethical rules.
C. If a CPA concludes that threats are at an acceptable level after applying the identified safeguards, then the CPA may proceed with the professional service.
D. To evaluate the significance of a threat, CPAs should evaluate identified threats in aggregate.

Answer: C, Taxonomy: Application, Difficulty: Hard, AICPA PC: Professional Behavior, AACSB: Ethics, Learning Objective: LO2.3, Solution: If a CPA concludes that threats are at an acceptable level after applying the identified safeguards, then the CPA may proceed with the professional service.

75. If the CPA is unable to implement effective safeguard to a threat of compliance with the accounting profession's ethical rules, he/she should _____.

A. proceed with the professional service
B. decline or terminate the engagement
C. limit the engagement to all non-audit areas
D. limit the engagement to only Federal taxation

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Answer: B, Taxonomy: Application, Difficulty: Hard, AICPA PC: Professional Behavior, AACSB: Ethics, Learning Objective: LO2.3, Solution: If a CPA is unable to implement effective safeguards, he/she should decline or terminate the engagement.

76. At step 5 when a CPA confronts threats to ethical decision-making and the safeguards applied to reduce the threat, what is the suggested best practice?

A. Document the identified threats, document the safeguards applied, and document the CPA's evaluation of the effectiveness of the safeguards.
B. Immediately decline the engagement, terminate the contract, and contact the AICPA.
C. Contact the FBI, tape all conversations with the client, then offer the engagement to a competitor.
D. Increase the fee charged to absorb any risk, immediately conclude that the threats are at an acceptable level and proceed with an internal control audit.

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA PC: Professional Behavior, AACSB: Ethics, Learning Objective: LO2.3, Solution: The CPA should document the identified threats, document the safeguards applied, and document the CPA's evaluation of the effectiveness of the safeguards.

77. A CPA works at a firm and also maintains a private practice as an expert witness for intellectual property cases. While at an audit client's office, he overhears a telephone conversation about a patent dispute and offers his services. When he takes the expert witness job, this position creates what type of threat to his professional ethics?

A. Familiarity threat
B. Advocacy threat
C. Self-interest threat
D. Self-review threat

Answer: B, Taxonomy: Application, Difficulty: Medium, AICPA PC: Professional Behavior, AACSB: Ethics, Learning Objective: LO2.3, Solution: This is an example of an advocacy threat.

78. According to the integrity and objectivity rule, in the performance of any professional service, a member shall not knowingly _____.

A. misrepresent facts

B. decentralize work to subordinates

C. omit a material fact

D. none of the above is correct

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA PC: Decision Making, AACSB: Ethics, Learning Objective: LO2.4, Solution: According to the integrity and objectivity rule, in the performance of any professional service, a member shall not knowingly misrepresent facts or subordinate judgment.

79. How does a small firm resolve the conflict of interest issue in a divorce case?

A. Provide tax services to only one of the two parties.

B. Using separate engagement teams in providing tax services to both parties.

C. Resign from the engagement.

D. They do not need to resolve the conflict of interest in the case of a divorce.

Answer: A, Taxonomy: Knowledge, Difficulty: Medium, AICPA PC: Decision Making, AACSB: Ethics, Learning Objective: LO2.4, Solution: A small firm remains free of conflict of interest in a divorce case by providing tax services to one of the two parties.

80. Which of the following issues arises when taxes are not properly distributed to the parties involved in a divorce case?

A. Conflict of interest

B. Misrepresentation of fact

C. Legal liability

D. Gross negligence

Answer: A, Taxonomy: Knowledge, Difficulty: Medium, AICPA PC: Decision Making, AACSB: Ethics, Learning Objective: LO2.4, Solution: A conflict of interest arises when tax is not properly distributed to the parties involved in a divorce case.

81. What should a CPA do if he/she concludes a difference of opinion with an audit supervisor regarding an on-going audit engagement may result in a material misrepresentation of fact or a violation of professional standards?

A. Quit the job.
B. Discuss his or her concerns with the supervisor.
C. Obtain more training.
D. Search for a certification that focuses on material misrepresentations.

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Answer: B, Taxonomy: Comprehension, Difficulty: Medium, AICPA PC: Professional Behavior, AACSB: Ethics, Learning Objective: LO2.4, Solution: The CPA should discuss his or her concerns with the supervisor.

82. The rule on integrity and objectivity applies to _____.

A. all services performed by CPAs
B. some services performed by CPAs
C. only audit, services performed by CPAs
D. only non-audit services performed by CPAs

Answer: A, Taxonomy: Comprehension, Difficulty: Easy, AICPA PC: Professional Behavior, AACSB: Ethics, Learning Objective: LO2.4, Solution: The rule on integrity and objectivity applies to all services performed by CPAs.

83. What are the two common issues that arise and are related to integrity and objectivity?

A. Conflicts of interest and subordination of judgment.
B. Ethical judgment and subjectivity.
C. Independence and compliance
D. Efficiency and effectiveness.

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA PC: Professional Behavior, AACSB: Ethics, Learning Objective: LO2.4, Solution: Conflicts of interest and subordination of judgment are the two common issues that arise related to integrity and objectivity.

84. The subordination of judgment threat is at an acceptable level when _____.

A. the CPA concludes the position taken by the firm does not result in a material misrepresentation of fact or a violation of applicable standards, laws, or regulations
B. the CPA does not have a difference of opinion related to the application of accounting principles, auditing standards, or other relevant professional standards
C. the CPA safeguards the position by also providing tax services
D. the CPA agrees to maintain confidentiality about the matter

Answer: A, Taxonomy: Comprehension, Difficulty: Hard, AICPA PC: Professional Behavior, AACSB: Ethics, Learning Objective: LO2.4, Solution: The subordination of judgment threat is at an acceptable level when the CPA concludes the position taken by the firm does not result in a material misrepresentation of fact or a violation of applicable standards, laws, or regulations.

85. When might self-interest, familiarity, and undue influence most likely threaten a CPA's compliance with integrity and objectivity?

A. When a CPA and his or her supervisor, or another person within the CPA firm, have a difference of opinion related to the application of accounting principles
B. When a CPA mistakenly applies the wrong auditing standard

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C. When a CPA pads his or her expense account
D. When a CPA takes concerns about an engagement to another partner

Answer: A, Taxonomy: Comprehension, Difficulty: Hard, AICPA PC: Professional Behavior, AACSB: Ethics, Learning Objective: LO2.4, Solution: When a CPA and his or her supervisor, or another person within the CPA firm, have a difference of opinion related to the application of accounting principles. self-interest, familiarity, and undue influence most likely threaten a CPAs compliance with integrity and objectivity.

86. A conflict of interest occurs when a CPA _____.

A. performs both tax and bookkeeping services for the same client
B. performs a professional service related to a particular matter involving two or more clients whose interests, with respect to that matter, are in conflict
C. represents a client in a divorce tax matter
D. represents a client in any legal dispute

Answer: B, Taxonomy: Comprehension, Difficulty: Easy, AICPA PC: Professional Behavior, AACSB: Ethics, Learning Objective: LO2.4, Solution: Conflict of interest occurs when a CPA performs a professional service related to a particular matter involving two or more clients whose interests, with respect to that matter, are in conflict.

87. What safeguards do most CPA firms have against conflicts of interest and subordination of judgment?

A. Specific policies to prevent the firm from violating professional standards and to protect the CPA.
B. Monetary settlements for severance pay to the CPA involved.
C. Whistleblower rules and regulations.
D. Human resource counseling and tip hotlines.

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA PC: Professional Behavior, AACSB: Ethics, Learning Objective: LO2.4, Solution: Most firms have specific policies to prevent the firm from violating professional standards and to protect the CPA.

88. If after discussing a potential subordination of judgment threat with a supervisor, a CPA does not feel that the matter is resolved, what should he or she do?

A. Discuss his or her concerns with the appropriate higher level(s) of management within the CPA's firm.
B. Contact the AICPA about the problem.
C. Immediately ask HR to reassign him or her.
D. Start looking for a new position at another firm.

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Answer: A, Taxonomy: Comprehension, Difficulty: Medium, AICPA PC: Professional Behavior, AACSB: Ethics, Learning Objective: LO2.4, Solution: The CPA should discuss his or her concerns with the appropriate higher level(s) of management within the CPA's firm.

89. In a small CPA firm, if the firm provides tax services to both parties who subsequently begin divorce proceedings, it is customary to do what?

A. Resign providing tax services to one of the two parties in a divorce to remain free of any conflict of interest.
B. Use separate engagement teams in providing tax services to the husband and to the wife, who are provided clear policies and procedures on maintaining confidentiality.
C. Engage in a background check on both parties.
D. Provide only consulting services to both parties.

Answer: A, Taxonomy: Application, Difficulty: Medium, AICPA PC: Professional Behavior, AACSB: Ethics, Learning Objective: LO2.4, Solution: The firm should resign from providing tax services to one of the two parties in a divorce to remain free of any conflict of interest.

90. A committee of the board of directors responsible for oversight of internal controls, financial reporting and disclosure in the financial statements, regulatory compliance, and the company's independent auditors is/are called (a/an) _____.

A. audit committee

B. covered members

C. executors

D. dependents

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA PC: Decision Making, AACSB: Ethics, Learning Objective: LO2.5, Solution: A committee of the board of directors responsible for oversight of internal controls, financial reporting and disclosure in the financial statements, regulatory compliance, and the company's independent auditors is called an audit committee.

91. Interpretation 1.295 indicates that before performing nonattest services, the CPA should establish and document in writing an understanding with the client regarding _____.

A. any limitations of the engagement, only

B. the objectives of the engagement and the services to be performed, only

C. the services to be performed, only

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D. the objectives of the engagement, the services to be performed, and any limitations of the engagement

Answer: D, Taxonomy: Knowledge, Difficulty: Easy, AICPA BB: Governance Perspective, AACSB: Ethics, Learning Objective: LO2.5, Solution: Interpretation 1.295 indicates that before performing nonattest services, the CPA should establish and document in writing an understanding with the client regarding the objectives of the engagement, the services to be performed, and any limitations of the engagement.

92. As a general rule, professional employees in a CPA firm who are not covered members and their immediate family members cannot _____.

A. be a trustee, director, or officer of an attest client or of the client's pension or profit-sharing trust

B. have a direct investment of more than 1% in an attest client

C. hold a non-key position with an attest client

D. have an indirect investment of more than 5% in an attest client

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA PC: Decision Making, AACSB: Ethics, Learning Objective: LO2.5, Solution: As a general rule, professional employees in a CPA firm who are not covered members and their immediate family members cannot have a direct investment of more than 5% in an attest client, hold a key position with an attest client, and be a trustee, director, or officer of an attest client or of the client's pension or profit-sharing trust.

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93. A _____ is someone who prepares or supervises others involved in preparing the financial statements or material accounting records or someone who is involved in accounting decision making.

A. key person

B. covered member

C. trustee

D. immediate family member

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA PC: Professional Behavior, AACSB: Communication, Learning Objective: LO2.5, Solution: A key person is someone who prepares or supervises others involved in preparing the financial statements or material accounting records or someone who is involved in accounting decision making.

94. SEC rules prohibit an audit firm from providing which of the following nonattest services to an audit client?

A. Actuarial services, only

B. Internal audit outsourcing and bookkeeping services, only

C. Bookkeeping and actuarial services, only

D. Internal audit outsourcing, bookkeeping, and actuarial services

Answer: D, Taxonomy: Knowledge, Difficulty: Easy, AICPA BB: Governance Perspective, AACSB: Ethics, Learning Objective: LO2.5, Solution: SEC rules prohibit an audit firm from providing the following nonattest services to an audit client: 1) Internal audit outsourcing services; 2) Bookkeeping services; and 3) Actuarial services.

95. Attest services do not include _____.

A. audits
B. reviews under SSARs
C. examinations, reviews and agreed-upon procedures under SSAE
D. compilation reports of financial statements

Answer D, Taxonomy: Knowledge, Difficulty: Easy, AICPA PC: Professional Behavior, AACSB: Ethics, Learning Objective: LO2.5, Solution: Attest services do not include compilations.

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96. “Independent in fact” is best defined as _____.

A. addressing potential conflicts of interest that can be observed or factually determined by others
B. acting with integrity and objectivity
C. acting in a way that is observable under the Rules of Conduct
D. acting with independence and integrity

Answer: B, Taxonomy: Knowledge, Difficulty: Easy, AICPA PC: Professional Behavior, AACSB: Ethics, Learning Objective: LO2.5, Solution: Independence in fact is best defined as acting with integrity and objectivity.

97. Being independent in appearance is best defined as _____.

A. addressing potential conflicts of interest that can be observed or factually determined by others
B. acting with integrity and objectivity
C. acting with independence and integrity
D. disclosing some of the common threats that he or she faces to acting independently

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA PC: Professional Behavior, AACSB: Ethics, Learning Objective: LO2.5, Solution: Independence in appearance is best defined as addressing potential conflicts of interest that can be observed or factually determined by others.

98. Section 1.200 of the AICPA Code of Professional Conduct specifies a number of circumstances that can impair _____.

A. the appearance of independence to guide CPAs in observable aspects of ethical conduct
B. the appearance of integrity regarding ethical conduct
C. safeguards that prevent a lack of independence
D. how to evaluate threats as an independent third-party

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA PC: Professional Behavior, AACSB: Ethics, Learning Objective: LO2.5, Solution: Section 1.200 specifies a number of circumstances that can impair the appearance of independence.

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99. A covered member, under the independence rules in the AICPA Code of Professional Conduct, is best defined as a person in a position to _____.

A. potentially influence attest decisions or the outcome of an attest engagement
B. potentially influence decisions or outcomes in non-audit services
C. take on or influence a third-party position
D. perform tax services that is both independent in fact and appearance

Answer: A, Taxonomy: Comprehension, Difficulty: Easy, AICPA PC: Professional Behavior, AACSB: Ethics, Learning Objective: LO2.5, Solution: A covered member is a person in a position to potentially influence attest decisions or the outcome of an attest engagement.

100. Which of the following statements is true?

A. A covered member can own one share of an attest client because it is immaterial.
B. A covered member cannot own a mutual fund which contains attest client shares, as long as the investment in the mutual fund is not material to the covered member.
C. A covered member can be an executor of an estate, which invests in an attest client, as long as the investment is not material.
D. A CPA firm as an entity is prohibited from the same activities as a covered member of the firm.

Answer: D, Taxonomy: Comprehension, Difficulty: Easy, AICPA PC: Professional Behavior, AACSB: Ethics, Learning Objective: LO2.5, Solution: A CPA firm as an entity is prohibited from the same activities as a covered member of the firm.

101. Which of the following activities is not a prohibited activity that impairs independence?

A. A direct investment in the attest client
B. A joint, closely held investment with an attest client that is material to the covered member
C. A material indirect investment in the attest client
D. Having a home mortgage from a bank who is an attest client

Answer: D, Taxonomy: Application, Difficulty: Easy, AICPA PC: Professional Behavior, AACSB: Ethics, Learning Objective: LO2.5, Solution: Having a home mortgage from a bank who is an attest client is allowed.

102. When can a spouse that works for an attestation client still participate in an employee benefit plan that includes employee stock ownership plans or employee stock option plans?

A. There are no restrictions.
B. when the benefits are offered equitably to all similar employees
C. When the benefits are offered equitably to a majority of similar employees

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D. As long as the CPA firm approves every stock-related plan

Answer: B, Taxonomy: Comprehension, Difficulty: Medium, AICPA PC: Professional Behavior, AACSB: Ethics, Learning Objective: LO2.5, Solution: A spouse can work for the attest client and still participate in an employee benefit plan that includes employee stock ownership plans or employee stock option plans as long as benefits are offered equitably to all similar employees.

103. Which of the following standards refers to undertaking professional services that can be completed with the appropriate level of professional skill?

A. Professional Competence

B. Due Professional Care

C. Sufficient Relevant Data

D. Planning and Supervision

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA FC: Reporting, AACSB: Ethics, Learning Objective: LO2.6, Solution: Professional Competence refers to undertaking professional services that can be completed with professional competence. (skill)

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104. According to the due professional care standard, CPAs should exercise professional care expected of _____ in the performance of professional services.

A. other CPAs

B. covered members

C. CPAs involved in consulting services

D. a reasonable person

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA FC: Reporting, AACSB: Ethics, Learning Objective: LO2.6, Solution: According to the due professional care standard, CPAs should exercise professional care expected of other CPAs in the performance of professional services.

105. Which of the following general standards refers to adequately preparing for the engagement and providing the appropriate management oversight to the performance of professional services?

A. Planning and Supervision

B. Sufficient Relevant Data

C. Due Care

D. Audit Planning

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA FC: Reporting, AACSB: Ethics, Learning Objective: LO2.6, Solution: Planning and Supervision is the general standard that expects CPAs to adequately plan and supervise the performance of professional services.

106. The general standards in the AICPA Code of Professional Conduct do NOT include _____.

A. professional competence
B. due professional care
C. planning for materiality
D. sufficient relevant data

Answer: C, Taxonomy: Knowledge, Difficulty: Easy, AICPA PC: Professional Behavior, AACSB: Ethics, Learning Objective: LO2.6, Solution: The general standards to not include planning for materiality.

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107. The definition for professional competence is _____.

A. undertake only those professional services that the member or the member's firm can reasonably expect to be completed with professional competence
B. exercise due professional care in the performance of professional services
C. adequately plan and supervise the performance of professional services
D. obtain sufficient relevant data to afford a reasonable basis for conclusions or recommendations in relation to any professional services performed

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA PC: Professional Behavior, AACSB: Ethics, Learning Objective: LO2.6, Solution: Professional competence is: undertake only those professional services that the member or the member's firm can reasonably expect to be completed with professional competence.

108. Which of the following standards is used for preparing financial statements with other accounting principles?

A. GAAP

B. GAAS

C. Rule 1.320 on Accounting Principles

D. Principles of the Code of Professional Conduct

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA BB: Governance Perspective, AACSB: Ethics, Learning Objective: LO2.7, Solution: Generally Accepted Accounting Principles (GAAP) is used for preparing financial statements with other accounting principles.

109. Which of the following should auditors know in regard to potential lawsuits against them?

A. People who can sue them

B. Allegations made in lawsuits

C. Defenses they can use in court

D. All the options are correct.

Answer: D, Taxonomy: Knowledge, Difficulty: Easy, AICPA FC: Reporting, AACSB: Communication, Learning Objective: LO2.7, Solution: Auditors should know people who can sue them, the allegations made in lawsuits, and defenses they can use in court.

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110. What should CPAs clarify while preparing financial statements for small businesses?

A. The financial reporting framework

B. The conceptual framework

C. Their role in nonattest services

D. Their part in an engagement

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA FC: Reporting, AACSB: Communication, Learning Objective: LO2.7, Solution: CPAs should clarify the financial reporting framework while preparing financial statements for small businesses on a cash basis of accounting or a federal income tax basis of accounting.

111. The rule on fees and other types of remuneration address how many circumstances that are extremely important?

A. 1
B. 2
C. 3
D. 4

Answer: B, Taxonomy: Knowledge, Difficulty: Easy, AICPA PC: Professional Behavior, AACSB: Ethics, Learning Objective: LO2.7, Solution: The rule of fees and other types of remuneration address two circumstances that are extremely important. These are Rule 1.510 on Contingent Fees and Rule 1.520 on Commissions and Referral Fees.

112. What is the other name of the Securities Act of 1933?

A. The Truth in Securities Act

B. The Antifraud Provisions Act

C. The Foreign Corrupt Practices Act

D. The Private Securities Litigation Reform Act

Answer: A, Taxonomy: Knowledge, Difficulty: Easy , AICPA BB: Governance Perspective, AACSB: Ethics, Learning Objective: LO2.9, Solution: The Securities Act of 1933 is known as the Truth in Securities Act and was enacted following the stock market crash and Great Depression of 1929 on May 27, 1933.

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113. _____ subjects auditors to penalties of fines or imprisonment or both.

A. Criminal liability

B. Proportionate liability

C. Diligence defense

D. Bookkeeping

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA FC: Reporting, AACSB: Communication, Learning Objective: LO2.9, Solution: Criminal liability subjects auditors to penalties of fines or imprisonment or both.

114. Under Section 18(a) of the Securities Act of 1934, the plaintiff _____.

A. may be any person buying or selling the securities

B. does not have to prove the existence of a materially false or misleading statement

C. does not have to prove reliance on such a statement and damage resulting from such reliance

D. had no knowledge of the false or misleading statement

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA BB: Governance Perspective, AACSB: Ethics, Learning Objective: LO2.9, Solution: Under Section 18(a) of the Securities Act of 1934, the plaintiff may be any person buying or selling the securities and must prove the existence of a materially false or misleading statement and reliance on such a statement and damage resulting from such reliance. Only the defendant has to prove that he/she had no knowledge of the false or misleading statement.

115. What is a due diligence defense?

A. An audit firm must show that it made a reasonable investigation, that the firm followed auditing standards, and accordingly had reasonable grounds to believe, and did believe, that the statements certified were true at the date of the statements and as of the time the registration statement became effective.
B. Not having to prove reliance on the false or misleading statement or that the loss suffered was the proximate result of the statement if purchase was made before the issuance of an income statement covering a period of at least 12 months following the effective date of the registration statement.
C. Basing a claim on an alleged materially false or misleading financial statement contained in the registration statement.
D. Concluding that subsequent events review was in conformity with generally accepted auditing standards.

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Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA PC: Professional Behavior, AACSB: Ethics, Learning Objective: LO2.9, Solution: In a due diligence defense, an audit firm must show that it made a reasonable investigation, that the firm followed auditing standards, and accordingly had a reasonable grounds to believe, and did believe, that the statements certified were true at the date of the statements and as of the time the registration statement became effective.

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Question Type: Text Entry

116. The _____ was the act passed in 2002 after the public was dissatisfied with the quality of audits of public companies.

A. Sarbanes-Oxley Act

Answer: N/A, Taxonomy: Knowledge, Difficulty: Easy, AICPA PC: Professional Behavior, AACSB: Ethics, Learning Objective: LO2.1, Solution: The public was not satisfied with the quality of audits of public companies. The result was the Sarbanes-Oxley Act of 2002 and the creation of the PCAOB to provide oversight of the auditors of public companies.

117. The _____ government grants a CPA license to those who pass the CPA exam and earn prescribed work experience.

A. state

Answer: N/A, Taxonomy: Knowledge, Difficulty: Easy, AICPA PC: Professional Behavior, AACSB: Ethics, Learning Objective: LO2.1, Solution: The state government grants a CPA license to those who pass the CPA exam and earn prescribed work experience.

118. A/an _____ is valued by the high level of skill rather than the concern for the public interest.

A. Expert Competitor | [EC Professional]

Answer: N/A, Taxonomy: Knowledge, Difficulty: Easy, AICPA PC: Professional Behavior, AACSB: Ethics, Learning Objective: LO2.1, Solution: The profession of an EC Professional is defined by the high level of skill, while that of a CPI Professional is recognized by the concern for the public interest.

119. _____ are accountancy bodies involved in the licensing of CPAs.

A. State Boards of Accountancy

Answer: N/A, Taxonomy: Knowledge, Difficulty: Easy, AICPA PC: Professional Behavior, AACSB: Ethics, Learning Objective: LO2.1, Solution: State Boards of Accountancy are accountancy bodies involved in the licensing of CPAs.

120. _____ are often referred to as “pros” because of their skill and level of expertise.

A. Professional athletes

Answer: N/A, Taxonomy: Knowledge, Difficulty: Easy, AICPA PC: Professional Behavior, AACSB: Ethics, Learning Objective: LO2.1, Solution: Professional athletes are often referred to as “pros” because of their skill and level of expertise.

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121. Auditors try to achieve independence in appearance in order to _____.

A. maintain public confidence in the profession

Answer: N/A, Taxonomy: Knowledge, Difficulty: Easy, AICPA PC: Decision Making, AACSB: Ethics, Learning Objective: LO2.1

122. _____ govern the performance of a member's professional responsibilities.

A. Principles

Answer: N/A, Taxonomy: Knowledge, Difficulty: Easy, AICPA BB: Governance Perspective, AACSB: Ethics, Learning Objective: LO2.2, Solution: Principles govern the performance of a member's professional responsibilities.

123. _____ may be designed in part to encourage ideal behavior, they must also be both practical and enforceable.

A. Codes of ethics

Answer: N/A, Taxonomy: Knowledge, Difficulty: Easy, AICPA BB: Governance Perspective, AACSB: Ethics, Learning Objective: LO2.2, Solution: Codes of ethics may be designed in part to encourage ideal behavior, they must also be both practical and enforceable.

124. A/an _____ threat is the threat that a CPA will take on the role of client management or otherwise assume management responsibilities.

A. management participation

Answer: N/A, Taxonomy: Knowledge, Difficulty: Easy, AICPA PC: Decision Making, AACSB: Ethics, Learning Objective: LO2.3, Solution: A management participation threat is the threat that a CPA will take on the role of client management or otherwise assume management responsibilities.

125. If a CPA concludes that the threat is not at an acceptable level, the CPA should _____.

A. identify and apply safeguards

Answer: N/A, Taxonomy: Knowledge, Difficulty: Easy, AICPA PC: Decision Making, AACSB: Ethics, Learning Objective: LO2.3, Solution: If a CPA concludes that the threat is not at an acceptable level, the CPA should identify and apply safeguards.

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126. If a CPA concludes that threats are at an acceptable level after applying the identified safeguards, then the CPA may proceed with the_____.

A. professional service

Answer: N/A, Taxonomy: Knowledge, Difficulty: Easy, AICPA PC: Decision Making, AACSB: Ethics, Learning Objective: LO2.3, Solution: If a CPA concludes that threats are at an acceptable level after applying the identified safeguards, then the CPA may proceed with the professional service.

127. In a _____ CPA firm, appropriate safeguards might include the involvement of another firm.

A. small

Answer: N/A, Taxonomy: Knowledge, Difficulty: Easy, AICPA PC: Decision Making, AACSB: Ethics, Learning Objective: LO2.3, Solution: In a small CPA firm, appropriate safeguards might include the involvement of another firm.

128. The two common issues related to integrity and objectivity are _____and _____.

A. conflicts of interest

B. subordination of judgment

Answer: N/A, Taxonomy: Knowledge, Difficulty: Easy, AICPA PC: Decision Making, AACSB: Ethics, Learning Objective: LO2.4, Solution: The two common issues related to integrity and objectivity are conflicts of interest and subordination of judgment.

129. A _____ firm may safeguard conflict of interest using separate engagement teams in providing tax services to both parties in a divorce.

A. large

Answer: N/A, Taxonomy: Knowledge, Difficulty: Easy, AICPA PC: Decision Making, AACSB: Ethics, Learning Objective: LO2.4, Solution: A large firm may safeguard conflict of interest using separate engagement teams in providing tax services to both parties in a divorce.

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130. The subordination of judgment threat is at an acceptable level if the CPA concludes that the position taken by the firm does not result in a _____.

A. material misrepresentation of fact

Answer: N/A, Taxonomy: Knowledge, Difficulty: Easy, AICPA PC: Decision Making, AACSB: Ethics, Learning Objective: LO2.4, Solution: The subordination of judgment threat is at an acceptable level if the CPA concludes that the position taken by the firm does not result in a material misrepresentation of fact.

131. If the investment in the mutual fund is material to the covered member, and the mutual fund owns any shares in an attest client, _____ is impaired.

A. independence

Answer: N/A, Taxonomy: Knowledge, Difficulty: Easy, AICPA PC: Decision Making, AACSB: Ethics, Learning Objective: LO2.5, Solution: If the investment in the mutual fund is material to the covered member, and the mutual fund owns any shares in an attest client, independence is impaired.

132. A _____ is in a position to potentially influence attest decisions or the outcome of an attest engagement.

A. covered member

Answer: N/A, Taxonomy: Knowledge, Difficulty: Easy, AICPA PC: Decision Making, AACSB: Ethics, Learning Objective: LO2.5, Solution: A covered member is a person in a position to potentially influence attest decisions or the outcome of an attest engagement.

133. An important issue for many spouses is their ability to participate in _____.

A. stock compensation plans

Answer: N/A, Taxonomy: Knowledge, Difficulty: Easy, AICPA PC: Decision Making, AACSB: Ethics, Learning Objective: LO2.5, Solution: An important issue for many spouses is their ability to participate in stock compensation plans.

134. According to the general standards of the AICPA Code, a member shall comply with the standards of professional services and any interpretations thereof by bodies designated by _____.

A. council

Answer: N/A, Taxonomy: Knowledge, Difficulty: Easy, AICPA BB: Governance Perspective, AACSB: Ethics, Learning Objective: LO2.6, Solution: According to the general standards of the AICPA Code, a member shall comply with the standards of professional services and any interpretations thereof by bodies designated by council.

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135. If a tax practitioner does not have experience performing audits or reviews, he/she should refer the engagement to a _____.

A. qualified CPA

Answer: N/A, Taxonomy: Knowledge, Difficulty: Easy, AICPA FC: Reporting, AACSB: Communication, Learning Objective: LO2.6, Solution: If a tax practitioner does not have experience performing audits or reviews, he/she should refer the engagement to another qualified CPA.

136. The general standards of the AICPA Code of Professional Conduct apply only to _____ in public practice.

A. CPA firms

Answer: N/A, Taxonomy: Knowledge, Difficulty: Easy, AICPA FC: Reporting, AACSB: Ethics, Learning Objective: LO2.6, Solution: The general standards of the AICPA Code of Professional Conduct apply only to CPA firms that perform professional services for clients.

137. A CPA should obtain _____ to afford a reasonable basis for conclusions or recommendations in relation to any professional services performed.

A. sufficient relevant data

Answer: N/A, Taxonomy: Knowledge, Difficulty: Easy, AICPA FC: Reporting, AACSB: Ethics, Learning Objective: LO2.6, Solution: A CPA should obtain sufficient relevant data to afford a reasonable basis for conclusions or recommendations in relation to any professional services performed.

138. Auditors have liability under _____ for addressing client requirements.

A. common law

Answer: N/A, Taxonomy: Knowledge, Difficulty: Easy, AICPA FC: Reporting, AACSB: Communication, Learning Objective: LO2.7, Solution: Auditors have liability under common law for addressing the client requirements.

139. Auditors have liability under _____ for addressing the requirements of third-party users of financial statements.

A. statutory law

Answer: N/A, Taxonomy: Knowledge, Difficulty: Easy, AICPA FC: Reporting, AACSB: Communication, Learning Objective: LO2.7, Solution: Auditors have liability under statutory law for addressing the requirements of third-party users of financial statements.

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140. The _____ rule does not preclude a CPA from initiating a complaint with the professional ethics division of the AICPA.

A. confidential client information

Answer: N/A, Taxonomy: Knowledge, Difficulty: Easy, AICPA BB: Governance Perspective, AACSB: Ethics, Learning Objective: LO2.7, Solution: The confidential client information rule does not preclude a CPA from initiating a complaint with the professional ethics division of the AICPA.

141. An individual or collective group who is not in privity with the parties to a contract is called a _____.

A. third party

Answer: N/A, Taxonomy: Knowledge, Difficulty: Easy, AICPA PC: Professional Behavior, AACSB: Communication, Learning Objective: LO2.8, Solution: An individual or collective group who is not in privity with the parties to a contract is called a third party.

142. The auditor's _____ is vital in refuting charges for breach of contract and breach of duty in a tort action.

A. documentation

Answer: N/A, Taxonomy: Knowledge, Difficulty: Easy, AICPA FC: Reporting, AACSB: Ethics, Learning Objective: LO2.8, Solution: The auditor's documentation is vital in refuting charges for breach of contract and breach of duty in a tort action.

143. Anyone identified to the auditor by name prior to the audit who is a recipient of the auditor's report is called a _____.

A. primary beneficiary

Answer: N/A, Taxonomy: Knowledge, Difficulty: Easy, AICPA PC: Professional Behavior, AACSB: Communication, Learning Objective: LO2.8, Solution: Anyone identified to the auditor by name prior to the audit who is a recipient of the auditor's report is called a primary beneficiary.

144. _____ refer(s) to unnamed third parties, such as creditors, stockholders, and potential investors, who use the auditor's report.

A. Other beneficiaries

Answer: N/A, Taxonomy: Knowledge, Difficulty: Easy, AICPA PC: Professional Behavior, AACSB: Communication, Learning Objective: LO2.8, Solution: Other beneficiaries refer to unnamed third parties, such as creditors, stockholders, and potential investors, who use the auditor's report.

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145. _____ arises when defendants who are not found to have "knowingly committed a violation" of the securities law are liable based on the defendant's percentage of responsibility.

A. Proportionate liability

Answer: N/A, Taxonomy: Knowledge, Difficulty: Easy, AICPA BB: Governance Perspective, AACSB: Ethics, Learning Objective: LO2.9, Solution: Proportionate liability arises when defendants who are not found to have "knowingly committed a violation" of the securities law are liable based on the defendant's percentage of responsibility.

146. _____ is established by the state and federal legislative bodies and specifically addresses the auditor's liability under certain circumstances.

A. Statutory law

Answer: N/A, Taxonomy: Knowledge, Difficulty: Easy, AICPA BB: Governance Perspective, AACSB: Ethics, Learning Objective: LO2.9, Solution: The statutory law is established by the state and federal legislative bodies and specifically addresses the auditor's liability under certain circumstances.

147. A _____ is the defense wherein an audit firm shows that it had made a reasonable investigation, had followed auditing standards, and accordingly had reasonable grounds to believe that the statements certified were true at the date of the statements and true of the time the registration statement became effective.

A. due diligence defense

Answer: N/A, Taxonomy: Knowledge, Difficulty: Easy, AICPA FC: Reporting, AACSB: Communication, Learning Objective: LO2.9, Solution: A due diligence defense is the defense wherein an audit firm shows that it had made a reasonable investigation, had followed auditing standards, and accordingly had reasonable grounds to believe that the statements certified were true at the date of the statements and true of the time the registration statement became effective.

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Question Type: Multiple choice multi select

148. Identify *two* possible threats that occur when a CPA and his or her supervisor have a difference of opinion related to the application of accounting principles, auditing standards, or other relevant professional standards?

A. Self-interest

B. Advocacy

C. Familiarity

D. Self-review

Answer: A, C, Taxonomy: Knowledge, Difficulty: Medium, AICPA PC: Decision Making, AACSB: Ethics, Learning Objective: LO2.4, Solution: Self-interest, familiarity, and undue influence threats may exist when a CPA and his or her supervisor have a difference of opinion related to the application of accounting principles, auditing standards, or other relevant professional standards.

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Question Type: Drop down

149. Match each of the threats below with the appropriate description.

A. Undue influence threat

||The threat that a CPA will subordinate his or her judgment to an individual associated with the client or a relevant third party.

B. Self-interest threat

||The threat that a CPA could benefit from an interest in, or relationship with, a client or persons associated with a client.

C. Management participation threat

||The threat that a CPA will take on the role of client leadership or assume such responsibilities.

D. Adverse interest threat

||The threat that a CPA will not act with objectivity because the CPA's interests are opposed to client interests.

Answer: 0, Taxonomy: Application, Difficulty: Easy, AICPA PC: Decision Making, AACSB: Ethics, Learning Objective: LO2.3, Solution: Undue influence threat—the threat that a CPA will subordinate his or her judgment to an individual associated with the client or a relevant third party.

Self-interest threat—the threat that a CPA could benefit from an interest in, or relationship with, a client or persons associated with a client.

Management participation threat—the threat that a CPA will take on the role of client leadership or assume such responsibilities.

Adverse interest threat—the threat that a CPA will not act with objectivity because the CPA's interests are opposed to client interests.

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150. Match the following entities with the appropriate categories.

A. covered member

||member of the engagement team

B. executor of an estate

||key management position

C. nondependent children

||close relative

D. dependent member

||immediate family member

Answer: 0, Taxonomy: Knowledge, Difficulty: Easy, AICPA PC: Decision Making, AACSB: Ethics, Learning Objective: LO2.5, Solution: A covered member may be a member of the engagement team. An executor of an estate holds a key management position. Nondependent children of a covered member are their close relatives. Dependent members of a covered member are their immediate family members.

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Question Type: Short Answer

151. Why do auditors try to achieve independence in appearance?

A. Auditors try to achieve independence in appearance in order to maintain public confidence in the profession.

Answer: N/A, Taxonomy: Knowledge, Difficulty: Easy, AICPA FC: Technology and Tools, AACSB: Ethics, Learning Objective: LO2.1

152. Can a CPA who has never audited a commercial bank, audit the bank?

A. The CPA may accept the engagement to audit the commercial bank after attaining a suitable level of understanding of the transactions and accounting practices unique to commercial banking.

Answer: N/A, Taxonomy: Knowledge, Difficulty: Easy, AICPA PC: Decision Making, AACSB: Ethics, Learning Objective: LO2.2

153. What is the conceptual difference between attestation standards and generally accepted auditing standards?

A. Attestation standards provide a framework for the attest function beyond historical financial statements.

Answer: N/A, Taxonomy: Knowledge, Difficulty: Medium, AICPA FC: Reporting, AACSB: Analytic, Learning Objective: LO2.3

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154. Darla Barker, CPA owns a small tax practice located in Ann Arbor, MI. Darla's family friend, Stephen Grey, owns a small security firm in Livonia, MI. Stephen's banker has decided that Stephen's company needs to submit audited financial statements in order to maintain Stephen's line of credit with the bank. Stephen emails Darla asking if she would be interested in performing the audit of his company. Stephen is on a tight deadline from the bank and would like the audited statements within 6 weeks. Darla's tax practice has never performed an audit for any client previously. Draft an email response from Darla to Stephen, referencing the appropriate section of the AICPA Code of Professional Conduct.

Answer: N/A, Taxonomy: Synthesis, Difficulty: Hard, AICPA BB: Governance Perspective, AACSB: Ethics, Learning Objective: LO2.6,

Solution: Students will submit different content here but the key points of their email responses should be to (1) thank Stephen for considering our firm, (2) respectively and politely decline the engagement, (3) explain why the engagement must be declined – we simply do not have the experience and knowledge necessary to complete the engagement within the required time frame, and (4) suggest another CPA who may be able to help Stephen.

The email response should reference the general standards: “A member shall comply with the following standards and with any interpretations thereof by bodies designated by Council:

1. **Professional Competence**. Undertake only those professional services that the member or the member's firm can reasonably expect to be completed with professional competence.
2. **Due Professional Care**. Exercise due professional care in the performance of professional services.
3. **Planning and Supervision**. Adequately plan and supervise the performance of professional services.
4. **Sufficient Relevant Data**. Obtain sufficient relevant data to afford a reasonable basis for conclusions or recommendations in relation to any professional services performed.”

155. STAR, CPA is auditing a not-for profit. Provide an example of due professional care with for this audit.

A. Several responses would be acceptable. For example, consultation with an independent appraiser regarding the valuation of fine art for a not-for-profit museum would evidence proper due care.

Answer: N/A, Taxonomy: Application, Difficulty: Medium, AICPA FC: Reporting, AACSB: Analytic, Learning Objective: LO2.6

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156. You have been hired to audit JarCakes, Inc., a small privately held local bakery that specializes in jarred cupcakes. As the bakery is small, they have requested that you do several other tasks for them. The bakery owner, Jared Sampson, is frequently out of town at conventions. As such, Jared has requested that you sign checks for him in emergency situations when he is out of town and payments must be made. In addition, when he is away, he has requested that the payroll clerk provide you with approved timecards to use in generating payroll checks. Jared's wife, Rita, is the accountant for JarCakes. She frequently attends conventions with her husband. Accordingly, Jared has also asked if it would be possible for you to post journal entries in the accounting. Rita would send you all information for any journal entries that are required, including the appropriate account classification. Additionally, Jared would like a new accounting information system installed. He considers you the expert, so he would like you to take full ownership of that project. As JarCakes is small and he has no IT staff, Jared would also like you to supervise his personnel in the daily operation of the new accounting information system. Finally, as Jared's expertise is in baking, and not in business, he would like you to serve in an investment advisory role for him, by recommending the allocation of funds that he should invest in various asset classes. Prepare a response to Jared, outlining which of his requests are allowed non-attest services and which of his requests are not allowed under the Independence rules.

Answer: N/A, Taxonomy: Application, Difficulty: Hard, AICPA PC: Decision Making, AACSB: Analytic, Learning Objective: LO2.5,

Solution: A CPA may not accept responsibility to authorize payment of client funds, or accept responsibility to sign or cosign client checks, even if only in emergency situations. When assisting a small business client with payroll using payroll time records provided and approved by the client, the CPA can generate unsigned checks or process the client's payroll. In an accounting service engagement for a nonpublic client, a CPA may record transactions for which management has determined or approved the appropriate account classification or post coded transactions to a client's general ledger. In an IT engagement, a CPA may design, install, or integrate a client's information system, provided the client makes all management decisions. However, a CPA may not supervise client personnel in the daily operation of a client's information system. In an investment advisory engagement with an attest and tax client, a CPA can recommend the allocation of funds that a client should invest in various asset classes, depending upon the client's desired rate of return, risk tolerance, and so on.

157. Patrick Bronson is the owner of a local CPA firm. His client, J.R.'s Convenience Store, is a small local business that records its transactions on a cash basis. Each year, Patrick's firm prepares financial statements for J.R.'s on a cash basis. Is this a violation of the accounting principles rule? How should the CPA treat the preparation of cash basis financial statements?

Answer: N/A, Taxonomy: Synthesis, Difficulty: Hard, AICPA BB: Governance Perspective, AACSB: Ethics, Learning Objective: LO2.7,

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Solution: No. It is appropriate and compliant that many small businesses use the cash basis. Financial statements prepared using a cash basis would be considered financial reporting frameworks other than generally accepted accounting principles (GAAP). In this situation, the client's financial statements, and the CPA's report thereon, should not purport that the financial statements are in accordance with GAAP, and the financial statements and the CPA's report should clarify the financial reporting framework used.

158. You are starting up a small CPA firm in your town. Your friend, Bruce, is an advisor at the local investment services firm. Bruce tells you this could be a great opportunity for both of you. Bruce suggests that you each pay each other a $100 referral fee for each client that you successfully refer to the other. Compose an answer to Bruce, in accordance with the AICPA Code of Professional Conduct.

Answer: N/A, Taxonomy: Synthesis, Difficulty: Hard, AICPA BB: Governance Perspective, AACSB: Ethics, Learning Objective: LO2.7,

Solution: Students will submit different content here but the key points of their answer to Bruce should be to (1) decline the offer and (2) explain that such an arrangement is not allowed per the AICPA Code of Professional Conduct. In general, entering into a referral fee associated with an attest client impairs independence due to the advocacy threat associated with these types of fees. It is appropriate for CPAs to accept a referral fee, with respect to non-attest clients. However, these fee arrangements are prohibited for attest clients as they impair independence.

159. Miller, CPAs is performing an audit of the financial statements of Big Craft Brewery. Pete Henderson, the CEO of Big Craft Brewery has requested that Miller CPAs omit the financial statement disclosures for segment reporting, as that is confidential information that could harm his competitive advantage, if made public. Draft an email from Miller CPAs to Pete Henderson in response to his request.

Answer: N/A, Taxonomy: Synthesis, Difficulty: Hard, AICPA BB: Governance Perspective, AACSB: Ethics, Learning Objective: LO2.7,

Solution: Students will submit different content here but the key elements in their email to Pete should be that omitting a required disclosure would be unacceptable. Then, explain that the rule on confidential client information should not be construed as relieving a CPA of his or her professional obligation to comply with accounting principles. Hence, a client cannot claim that information should not be disclosed in financial statements due to client confidentiality if the information is required by GAAP.

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160. Compare and contrast auditor liability under contract law vs. tort law.

Answer: N/A, Taxonomy: Evaluation, Difficulty: Hard, AICPA BB: Governance Perspective, AACSB: Ethics, Learning Objective: LO2.8,

Solution: An auditor may be liable to a client for **breach of contract** when the audit firm:

- Issues a standard audit report when he or she has not made an audit in accordance with generally accepted auditing standards (GAAS).
- Does not deliver the audit report by the agreed-upon date.
- Violates the client's confidential relationship.

A CPA may also be liable to a client under tort law. A **tort** is a wrongful act that injures another person's property, body, or reputation. A tort action may be based on any one of the following causes:

- **Ordinary negligence -** Failure to exercise the degree of care a person of ordinary prudence (a reasonable person) would exercise under the same circumstances.
- **Gross negligence -** Failure to use even slight care in the circumstances.
- **Fraud -.** Intentional deception, such as misrepresentation, concealment, or nondisclosure of a material fact, that results in injury to another. In some cases a distinction has been made between fraud and constructive fraud. Constructive fraud may be inferred from gross negligence or reckless disregard for the truth.

161. Briefly compare the differences between ordinary negligence, gross negligence, and fraud.

Answer: N/A, Taxonomy: Evaluation, Difficulty: Hard, AICPA BB: Governance Perspective, AACSB: Ethics, Learning Objective: LO2.8,

Solution:

- **Ordinary negligence -** Failure to exercise the degree of care a person of ordinary prudence (a reasonable person) would exercise under the same circumstances.
- **Gross negligence -** Failure to use even slight care in the circumstances.
- **Fraud -.** Intentional deception, such as misrepresentation, concealment, or nondisclosure of a material fact, that results in injury to another. In some cases a distinction has been made between fraud and constructive fraud. Constructive fraud may be inferred from gross negligence or reckless disregard for the truth.

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162. Evaluate the following statement:

Maria Boynton is the plaintiff in a case against Sutherby & Alton, CPAs, arguing that she suffered a loss by relying on the financial statements of Big Box, Inc., which were audited by Sutherby & Alton, CPAs. Under the Securities Act of 1933, Marcia must prove that the auditors were negligent or fraudulent in certifying the financial statements involved.

Answer: N/A, Taxonomy: Evaluation, Difficulty: Hard, AICPA BB: Governance Perspective, AACSB: Ethics, Learning Objective: LO2.9,

Solution: According to the Securities Act of 1933, the plaintiff (e.g., investors):

- May be any person acquiring securities described in the registration statement, whether or not he or she is a client of the auditor.
- Must base the claim on an alleged materially false or misleading financial statement contained in the registration statement.
- Does not have to prove reliance on the false or misleading statement or that the loss suffered was the proximate result of the statement if purchase was made before the issuance of an income statement covering a period of at least 12 months following the effective date of the registration statement.
- **Does not have to prove that the auditors were negligent or fraudulent in certifying the financial statements involved.**

163. The Sarbanes-Oxley Act of 2002 made it unlawful to perform audit services for a public company and also perform the certain nonattest services for audit clients. List three of the prohibited services and come up with an example of why it may be inappropriate for an auditor to perform both an audit and that particular service.

Answer: N/A, Taxonomy: Evaluation, Difficulty: Medium, AICPA BB: Governance Perspective, AACSB: Ethics, Learning Objective: LO2.9,

Solution: Specific student answers will vary but should address the ethical implications and threats to independence, conflicts of interest, etc. SOX makes it “unlawful” to perform audit services for a public company and also perform the following nonattest services for audit clients:

- Bookkeeping or other services related to the accounting records or financial statements of the audit client
- Financial information systems design and implementation
- Appraisal or valuation services, fairness opinions, or contribution-in-kind reports
- Actuarial services

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- Internal audit outsourcing services
- Management functions or human resources
- Broker or dealer, investment adviser, or investment banking services
- Legal services and expert services unrelated to the audit
- Any other service that the PCAOB determines, by regulation, is impermissible

164. Tim O'Neal, CEO of a public company, explains to you, his auditor, that he does not believe he is responsible for the fair presentation of his company's financial statements. Afterall, isn't that what he hired you for? Draft a response to Mr. O'Neal.

Answer: N/A, Taxonomy: Synthesis, Difficulty: Hard, AICPA BB: Governance Perspective, AACSB: Ethics, Learning Objective: LO2.9,

Solution: Specific student answers will vary but should address that management is responsible for the fair presentation of the financial statements and that the auditor is responsible for following GAAS and issuing an opinion on the fair presentation of the financial statements. Section 302 requires a public company's CEO and CFO to prepare a statement to accompany the audit report to certify the "appropriateness of the financial statements and disclosures contained in the periodic report, and that those financial statements and disclosures fairly present, in all material respects, the operations and financial condition of the issuer." It also creates a liability for the CEO and CFO who knowingly and intentionally make false certifications.

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