Auditing Practical Approach with Data Analytics 2nd edition Johnson Test Bank

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Chapter 1

Introduction and Overview of Audit and Assurance

Question Type: True or False

1. GAAP and IFRS are examples of applicable financial reporting framework.
   A. True
   B. False

   Ans: A, LO: 1, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Communication, AICPA FC: Reporting

   Solution: The *applicable financial reporting framework* refers to the set of standards used in preparing the historical financial statements, such as GAAP, IFRS or a Federal Income Tax Basis of Accounting.

2. Review of financial forecasts falls under attestation services.
   A. True
   B. False

   Ans: A, LO: 1, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA FC: Measurement Analysis and Interpretation

   Solution: Attestation services (under the umbrella of assurance services) include review of historical financial statements, review of financial forecasts, and examination of internal control.

3. Within a U.S. context, the applicable financial reporting framework is typically Generally Accepted Accounting Principles (GAAP).
   A. True
   B. False

   Ans: A, LO: 2, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA FC: Measurement Analysis and Interpretation

   Solution: Within a U.S. context, the applicable financial reporting framework is typically generally accepted accounting principles (GAAP).

4. Private companies, or non-issuers, are not required by the U.S. government to have an annual financial statement audit
   A. True
   B. False

   Ans: A, LO: 2, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Analytic, AICPA FC: Reporting

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Solution: Private companies, or non-issuers, are not required by the U.S. government to have an annual financial statement audit, but often other interested users, such as a bank or lender, may request that a private company provide audited financial statements.

5. One of the reasons there is a demand for financial statement audits is that users of financial statements often lack accounting and legal knowledge to fully understand complex accounting and disclosure choices.
   A. True
   B. False

Ans: A, LO: 3, Bloom: C, Difficulty: Easy, Min: 1, AACSB: Analytic, AICPA PC: Communication

Solution: Financial statements are complex, the amounts are often affected by significant estimates, and the disclosures often require significant knowledge and experience to evaluate. Most financial statement users do not have the accounting and legal knowledge to assess the reasonableness of complex accounting and disclosure choices being made by the company.

6. In financial accounting, the balance sheet is a statement of financial position
   A. True
   B. False

Ans: A, LO: 3, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Analytic, AICPA PC: Communication

Solution: In financial accounting, the financial statements include the balance sheet (statement of financial position), income statement (statement of comprehensive income), statement of cash flows, statement of changes in equity and accompanying notes.

7. Business valuation falls within the purview of non-assurance services.
   A. True
   B. False

Ans: A, LO: 4, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Analytic, AICPA FC: Measurement Analysis and Interpretation

Solution: Many of these accounting firms provide non-assurance (or non-audit) services as well as assurance services. These non-assurance services include management consulting, business valuation, mergers and acquisitions, insolvency, tax and accounting services.

8. Securities Exchange Act of 1934 regulates the ongoing trading of securities after the initial public offering and requires the annual audit of a public company's financial statements.
   A. True
   B. False

Ans: A, LO: 5, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective

Solution: The Securities Exchange Act of 1934 regulates the ongoing trading of securities after the initial public offering and requires the annual audit of a public company's financial statements.

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9. The Securities Act of 1933 enhances annual financial disclosures for public companies and placed more emphasis on corporate responsibility.
   A. True
   B. False

   Ans: B, LO: 5, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective

   Solution: The Securities Act of 1933 regulates the disclosure of financial information in a company's initial public offering of stock and requires that the financial information be audited.

10. Neither client characteristics nor actions of the auditor affect the audit risk.
   A. True
   B. False

   Ans: B, LO: 6, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA FC: Reporting

   Solution: Audit risk is affected by client characteristics as well as actions of the auditor.

11. Materiality is a relative concept, and it differs from company to company and from year to year for a given company.
   A. True
   B. False

   Ans: A, LO: 6, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA FC: Reporting

   Solution: Materiality is a relative concept, and it differs from company to company and from year to year for a given company. Auditors design an audit to provide reasonable assurance that the financial statements are free of material misstatement. However, auditors do *not* design an audit to look for *immaterial* misstatements because they would not influence a financial statement user.

12. When auditors determine that the financial statements of a public company are presented fairly in accordance with the applicable financial reporting framework, they issue a type of report that PCAOB standards call "the standard clean report."
   A. True
   B. False

   Ans: B, LO: 6, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA FC: Reporting

   Solution: If auditors have determined the financial statements are presented fairly in accordance with the applicable financial reporting framework, they issue the standard *unqualified* report. The PCAOB standards use the term "unqualified" report.

13. In an unqualified audit report on the financial statements of a public company, the concluding statement of the Basis for Opinion paragraph mentions reasonable basis for the audit firm's opinion.
   A. True
   B. False

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Ans: A, LO: 6, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA FC: Reporting

Solution: The basis for opinion paragraph explains, in brief terms, the process of conducting an audit. It mentions the concept of reasonable assurance about whether the financial statements are free of material misstatement. It includes an explicit statement that PCAOB audit standards were followed because the audit pertains to a public company. The scope paragraph also includes a brief discussion of the professional judgments made during the audit. Finally, it concludes with a statement that the audit firm believes that its audit provides a reasonable basis for its opinion.

14. In an audit report on the effectiveness of ICFR for a public company, the basis for opinion paragraph states the different responsibilities of management and auditors.
A. True
B. False

Ans: B, LO: 7, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Communication, AICPA BB: Governance Perspective

Solution: In an audit report on the effectiveness of ICFR for a public company, the basis for opinion paragraph states the different responsibilities of management and auditors. Like the audit report on the financial statements, this paragraph references registration with the PCAOB and independence requirements of the SEC and other federal securities laws.

15. In an audit report on the effectiveness of ICFR for a public company, the Opinion on Internal Control over Financial Reporting paragraph mentions that auditors are only required to obtain reasonable assurance about whether the company maintained, in all material respects, effective ICFR.
A. True
B. False

Ans: A, LO: 7, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Communication, AICPA BB: Governance Perspective

Solution: In an audit report on the effectiveness of ICFR for a public company, the Opinion on Internal Control over Financial Reporting paragraph explains that auditors conducted their audit in accordance with the standards of the PCAOB. In brief terms, it explains the process of conducting an audit of the effectiveness of ICFR. It mentions that auditors are only required to obtain reasonable assurance about whether the company maintained, in all material respects, effective ICFR. It concludes with a statement that the audit firm believes its audit provides a reasonable basis for its opinion.

16. A financial statement user's expectations are only impacted by legislation.
A. True
B. False

Ans: B, LO: 8, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Communication, AICPA FC: Measurement Analysis and Interpretation

Solution: A financial statement user's expectations are often impacted by audit standards, ethical standards, regulations, legislation, and firm policy and procedures.

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17. The audit expectation gap is caused by user expectations such as: The auditor will catch all instances of fraud.
    A. True
    B. False

    Ans: A, LO: 8, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Communication, AICPA FC: Reporting

    Solution: The audit expectation gap is caused by unrealistic user expectations such as: the auditor is providing complete assurance; the auditor is guaranteeing the future viability of the entity; an unmodified audit opinion is an indicator of complete accuracy of the financial statements; the auditor will definitely find any and all fraud; and that the auditor has checked all transactions.

Question Type: Multiple choice

18. Identify a service that falls under audit services.
    A. examination of historical financial statements
    B. compilation of historical financial statements
    C. inspection of website security
    D. review of financial forecast

    Ans: A, LO: 1, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA FC: Measurement Analysis and Interpretation

    Solution: Examination of historical financial statements comes under audit services.

19. Examination of internal controls is a service that comes under _____ services, which fall under _____ services.
    A. audit; assurance
    B. assurance; attestation
    C. acceptable; assurance
    D. attestation; audit

    Ans: A, LO: 1, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA FC: Measurement Analysis and Interpretation

    Solution: Attestation services (under the umbrella of assurance services) include review of historical financial statements, review of financial forecast, and examination of internal control.

20. Compared to an audit of historical financial statements, a review engagement is _____.
    A. less extensive and also less expensive
    B. more extensive and also more expensive
    C. less extensive but more expensive
    D. more extensive but less expensive

    Ans: A, LO: 1, Bloom: C, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA FC: Measurement Analysis and Interpretation

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Solution: In a review engagement, the practitioner expresses *limited assurance* that no material modifications need to be made to the financial statements. So, a review of historical financial statements is a less extensive, and therefore, less expensive service that can be very useful for smaller private companies.

21. Who are the only *licensed* accounting professionals in the United States?
    A. Certified Public Accountants (CPA)
    B. Chartered Accounts (CA)
    C. Financial Accountants (FA)
    D. Chief financial and operating officer (CFOO)

Ans: A, LO: 1, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA FC: Measurement Analysis and Interpretation

Solution: Certified Public Accountants (CPA) are the only *licensed* accounting professionals in the United States.

22. As attestation services encompass more than just the inspection of historical financial statements, the term _____ is used rather than _____.
    A. *practitioner; auditor*
    B. *auditor; practitioner*
    C. *intended user; auditor*
    D. intended user; practitioner

Ans: A, LO: 1, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Communication, AICPA FC: Reporting

Solution: In attestation services, the term practitioner is used rather than auditor because attestation services encompass more than just the audit of historical financial statements.

23. What services are defined as independent professional services that improve the quality of information, or its context, for decision makers?
    A. assurance services
    B. attestation services
    C. absolute assurance
    D. audit services

Ans: A, LO: 1, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Communication, AICPA FC: Reporting

Solution: Assurance services are defined as independent professional services that improve the quality of information, or its context, for decision makers.

24. The most common assurance service is the _____.
    A. audit of a company's historical financial statements
    B. compilation of financial statements
    C. review of a company's financial controls
    D. review of a company's historical financial statements

Ans: A, LO: 1, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Communication, AICPA FC: Reporting

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Solution: The audit of a company's historical financial statements is the most common assurance service.

25. A *review* of historical financial statements is an example of _____.
    A. attestation service
    B. absolute assurance
    C. financial forecast
    D. applicable financial reporting framework

Ans: A, LO: 1, Bloom: C, Difficulty: Easy, Min: 1, AACSB: Communication, AICPA FC: Reporting

Solution: An example of an attestation service is a review of historical financial statements.

26. Assurance, attestation, and auditing are similar because all three represent a common process of _____.
    A. taking information prepared by someone else and comparing that information to an established set of criteria.
    B. compiling and reviewing historical financial statements and providing non-financial information.
    C. compiling historical financial statements and providing non-financial information and web security.
    D. reviewing financial forecast, examining internal controls, and providing website security.

Ans: A, LO: 1, Bloom: C, Difficulty: Easy, Min: 1, AACSB: Communication, AICPA FC: Reporting

Solution: The terms assurance, attestation, and auditing are sometimes used interchangeably, but they actually represent different types of services. They are similar because they all represent a common process of an independent accounting firm taking information prepared by someone else and comparing that information to an established set of criteria.

27. Which of the following is true of assurance services?
    A. Both attestation and auditing services fall under the term of assurance services.
    B. The term *information* refers to subject matter that is an entire system, not standalone data.
    C. The services are performed by someone who was involved with the creation of the information.
    D. The *intended user* is an independent Certified Public Accountant qualified to perform the auditing service.

Ans: A, LO: 1, Bloom: C, Difficulty: Easy, Min: 1, AACSB: Communication, AICPA FC: Reporting

Solution: Both attestation and auditing services fall under the term of assurance services. The term *independent* implies that the service is performed by someone who was not involved with the creation of the information and who is objective in the evaluation of the information. The term *information* refers to subject matter that can be standalone data or entire systems. The *auditor* refers to an independent Certified Public Accountant, or CPA, who is qualified to perform the auditing service.

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28. When CPAs are hired to report on the integrity of financial forecasts and reports on financial reporting processes, it is called an _____.
A. attestation service
B. absolute assurance
C. applicable financial reporting framework
D. audit service

Ans: A, LO: 1, Bloom: C, Difficulty: Easy, Min: 1, AACSB: Communication, AICPA FC: Reporting

Solution: Companies produce financial information that goes beyond historical financial statements. Examples include financial forecasts and reports on financial reporting processes. When CPAs are hired to report on the integrity of this type of financial information, it is called an attestation service.

29. In assurance services, the term "*information*" refers to subject matter that is _____.
A. historical or prospective
B. created by independent or in-house services
C. financial and outside the purview of the non-financial
D. internal to a company only

Ans: A, LO: 1, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Communication, AICPA FC: Reporting

Solution: In the assurance services, the term *information* refers to subject matter that can be financial or non-financial, historical or prospective, or standalone data or entire systems, internal or external to a company.

30. Which terms does the textbook claim are used interchangeably, but actually represent different types of services?
A. assurance, attestation, and auditing
B. accounting, auditing, and assurance
C. accounting, attestation, and auditing
D. assurance, attestation, and accounting

Ans: A, LO: 1, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Analytic, AICPA FC: Reporting

Solution: Assurance, attestation and auditing are used interchangeably but represent different services.

31. Which of the following is included as a focus of assurance services?
A. Compilation of historical financial statements
B. Examination of internal controls
C. Review of historical financial statements
D. Review of financial forecast

Ans: C, LO: 1, Bloom: C, Difficulty: Easy, Min: 1, AACSB: Analytic, AICPA FC: Reporting

Solution: A review is a type of assurance service.

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32. A key similarity between assurance, attestation, and auditing services is _____.
A. the comparison of information prepared by someone else against an established set of criteria
B. the comparison of actual output to projected output
C. the comparison of financial accounting data to managerial accounting data
D. the comparison of financial audit data to tax audit data

Ans: A, LO: 1, Bloom: C, Difficulty: Easy, Min: 1, AACSB: Analytic, AICPA FC: Reporting

Solution: Assurance, attestation, and auditing services involve the comparison of information prepared by someone else against an established set of criteria.

33. The purpose of audit services is to provide _____.
A. financial statement users with an opinion as to the fair presentation of the financial reporting
B. management with an opinion as to the fairness of the company's managerial accounting procedures
C. investment advice to the company
D. limited assurance that no material modifications need to be made to the financial statements

Ans: A, LO: 1, Bloom: C, Difficulty: Easy, Min: 1, AACSB: Analytic, AICPA FC: Reporting

Solution: The purpose of an audit is to provide financial statement users with an opinion as to the fair presentation of the financial reporting.

34. Which are the most specific services provided by the auditor?
A. Compilation services
B. Audit services
C. Attestation services
D. Assurance services

Ans: B, LO: 1, Bloom: C, Difficulty: Easy, Min: 1, AACSB: Analytic, AICPA FC: Reporting

Solution: Audit services are the most specific.

35. Which is the most inclusive or broadest service provided by the auditor?
A. Audit services
B. Attestation services
C. Assurance services
D. A review of historical financial statements

Ans: C, LO: 1, Bloom: C, Difficulty: Easy, Min: 1, AACSB: Analytic, AICPA FC: Reporting

Solution: Assurance services are the broadest service.

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36. The only professional who can audit a set of historical financial statements for a public or private company in the United States is _____.
    A. a Certified Public Accountant (CPA)
    B. a Certified Fraud Examiner (CFE)
    C. the IRS
    D. a loan officer

    Ans: A, LO: 1, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Analytic, AICPA FC: Reporting

    Solution: A CPA is the only professional in the United States who can audit a set of historical financial statements for a public or private company.

37. The set of standards used in preparing the historical financial statements, such as GAAP or IFRS, is referred to as _____.
    A. the applicable financial reporting framework
    B. Generally Accepted Auditing Standards (GAAS)
    C. material modifications
    D. a review of historical financial statements

    Ans: A, LO: 1, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Analytic, AICPA FC: Reporting

    Solution: The set of standards used in preparing the historical financial statements is referred to as the applicable financial reporting framework.

38. Any group that will be using the financial statements to make decisions, such as investors and creditors, is known as _____.
    A. intended users
    B. groups of standing
    C. decision-makers
    D. practitioners

    Ans: A, LO: 1, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Analytic, AICPA FC: Reporting

    Solution: Intended users are any group that will be using the financial statements to make decisions.

39. Which of the following is not one of the three E's needed to become a licensed CPA?
    A. Education
    B. Examination
    C. Experience
    D. Efficiency

    Ans: D, LO: 1, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Analytic, AICPA FC: Reporting

    Solution: The three E's are education, examination, and experience.

40. The only licensed accounting professionals in the United States are:
    A. Certified Public Accountants

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B. Chartered Accountants
C. Certified Internal Auditors
D. Certified Fraud Examiners

Ans: A, LO: 1, Bloom: C, Difficulty: Easy, Min: 1, AACSB: Analytic, AICPA FC: Reporting

Solution: CPAs are the only licensed accounting professionals in the United States.

41. Assurance services are defined as _____.
A. independent professional services that improve the quality of information, or its context, for decision makers
B. individual provisional services to improve internal controls for financial statement users
C. individual prospective financial statement quality
D. independent information improvement

Ans: A, LO: 1, Bloom: C, Difficulty: Easy, Min: 1, AACSB: Analytic, AICPA FC: Reporting

Solution: Assurance services are independent professional services that improve the quality of information, or its context, for decision makers.

42. Which type of entity generally finds a review of historical financial statements to be the most useful?
A. Large public corporations
B. Small public corporations
C. Large private corporations
D. Small private corporations

Ans: D, LO: 1, Bloom: C, Difficulty: Easy, Min: 1, AACSB: Analytic, AICPA FC: Reporting

Solution: Small private corporations typically find reviews to be the most useful.

43. Which of the following is a characteristic of an audit of historical financial statements?
A. It provides limited assurance that no material modifications need to be made to the financial statements.
B. It expresses an opinion on the fair presentation of the financial statements.
C. It is the same as an examination of internal controls.
D. It is broader than a review engagement.

Ans: B, LO: 1, Bloom: C, Difficulty: Easy, Min: 1, AACSB: Analytic, AICPA FC: Reporting

Solution: An audit expresses an opinion on the fair presentation of the financial statements.

44. Which of the following is not one of the four sections tested on the CPA exam?
A. Auditing and Attestation
B. Business Environment and Concepts

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C. Regulation
D. Internal Controls

Ans: D, LO: 1, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Analytic, AICPA FC: Reporting

Solution: Internal controls are not one of the four parts of the CPA exam.

45. What is the final step in becoming a licensed CPA?
A. Taking the CPA exam
B. Meeting the educational requirements
C. Work experience
D. Pass an examination on the Rules of Professional Conduct

Ans: C, LO: 1, Bloom: C, Difficulty: Easy, Min: 1, AACSB: Analytic, AICPA FC: Reporting

Solution: The final step is getting the required work experience.

46. Independent professional attestation services improve the quality of information. Quality is best described as an improvement in informational _____.
A. relevance and reliability.
B. financial and nonfinancial qualities
C. historical and prospective qualities
D. internal and external qualities

Ans: A, LO: 1, Bloom: C, Difficulty: Easy, Min: 1, AACSB: Analytic, AICPA FC: Reporting

Solution: Relevance and reliability improve the quality of information.

47. The term practitioner would be least likely to be used when referring to the performance of _____.
A. Audit services
B. Attestation services
C. Assurance services
D. Bookkeeping services

Ans: A, LO: 1, Bloom: C, Difficulty: Easy, Min: 1, AACSB: Analytic, AICPA FC: Reporting

Solution: The term practitioner would least likely be used when referring to an audit because it is so specific that professionals who perform audits are called auditors.

48. A review of historical financial statements as compared to an audit of historical financial statements _____.
A. is more extensive in terms of the work product required
B. is typically less expensive
C. provides greater assurance
D. provides an opinion

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Ans: B, LO: 1, Bloom: C, Difficulty: Easy, Min: 1, AACSB: Analytic, AICPA FC: Reporting

Solution: A review is typically less expensive than an audit because much less time and effort are involved.

49. The term independent with respect to assurance services implies that the service is _____.
A. performed by someone who was not involved with the creation of the information.
B. performed by someone who was involved with the creation of the information and, therefore, fully understands it.
C. performed by a company employee.
D. is subjective.

Ans: A, LO: 1, Bloom: C, Difficulty: Easy, Min: 1, AACSB: Analytic, AICPA FC: Reporting

Solution: Independence implies that the service is performed by someone who was not involved with the creation of the information.

50. Examination of non-financial information falls under _____ services and outside of_____ services.
A. Assurance; Audit
B. Attestation; Assurance
C. Audit; Assurance
D. Attestation; Audit

Ans: A, LO: 1, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA FC: Measurement Analysis and Interpretation

Solution: Assurance services include compilation of historical statements, website security, IT operations, and non-financial information. Attestation services (under the umbrella of assurance services) include review of historical financial statements, review of financial forecast, and examination of internal control. Historical financial statements come under audit services.

51. Among the various processes relating to auditing and assurance standards, the largest umbrella represents _____ services.
A. Assurance
B. Attestation
C. Audit
D. Review

Ans: A, LO: 1, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA FC: Measurement Analysis and Interpretation

Solution: Among the various processes relating to auditing and assurance standards, the largest umbrella represents assurance services: independent professional services that improve the quality of information, or its context, for decision makers.

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52. Argon, a new hire in Sky and Co. audit firm, was attending a training on the different service offerings being provided by the firm to its clients. Being a new professional in the audit industry, Argon was surprised to know that aside from Audit services, the firm also provides other Assurance and Attestation services which are terms Argon was not knowledgeable previously. Which among the following statements is correct when discussing the relationship between Assurance, Attestation, and Audit services?
    A. Independent CPAs can only perform Audit services, while Assurance and Attestation services are for non-independent CPAs only.
    B. The difference between the three services lies on the subject matter being audited or reviewed since only Audit services involve financial information while the others do not.
    C. Among the three services, Audit is the most specific and it involves the audit of financial statements and internal controls over financial reporting.
    D. Assurance, Attestation, and Audit services vary in terms of the type of client involved wherein Audit services can only be provided to public companies while the others are for private companies as well.

    Ans: C, LO: 1, Bloom: AN, Difficulty: Medium, Min: 1, AACSB: Analytic, AICPA FC: Risk Assessment, Analysis and Management

    Solution: Audit services are the most specific and narrow of the three services. Two primary types of audit services are an audit of financial statements and an audit of internal controls over financial reporting (ICFR).

53. Lotus was assigned to perform a review on the financial statements of Arsenia Company. Upon receiving the assignment, Lotus was delighted as the CEO of Arsenia is a close family member. However, Lotus was unsure whether or not Lotus is allowed to perform this engagement because of a possible threat to independence. Should Lotus be allowed to review the financial statements of Arsenia Company?
    A. No. Independence is required when performing a review engagement since this is under Assurance services.
    B. Yes. Even if Lotus is not independent with Arsenia Company, Lotus will be allowed since only a review will be performed and not an audit.
    C. No. Lotus will only be allowed despite the threat to independence if an audit will be performed instead of a review.
    D. Yes. Lotus will be allowed since there is only a threat to independence which can still be proven otherwise.

    Ans: A, LO: 1, Bloom: AN, Difficulty: Medium, Min: 1, AACSB: Analytic, AICPA FC: Risk Assessment, Analysis and Management

    Solution: Independence is not required to provide non-assurance services. These non-assurance services include management consulting, business valuation, mergers and acquisitions, tax, and accounting.

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54. Cloud, the auditor assigned to perform financial statement audit for Tin Company, was having a meeting with the client's representatives. Cloud was explaining to them the nature of the financial statement audit and the high-level audit procedures designed to discover misstatements. However, the client's representatives expressed their expectation for Cloud to detect all errors and misstatements in their financial statements as they want to present 100% accurate information as much as possible to their shareholders. Which among the following is the best response to this expectation?
A. Detecting all misstatements and errors in the financial statements is the main objective of the audit so the client's expectation is valid.
B. Audit procedures selected in an audit are designed only to discover material misstatements due to time and cost constraints.
C. The extensiveness of the audit procedures planned in detecting misstatements will depend on the level of fee arranged between the auditor and the client.
D. The audit procedures to be performed in the engagement should not be based on any expectation of detecting any misstatements in order to avoid bias.

Ans: B, LO: 2, Bloom: AN, Difficulty: Medium, Min: 1, AACSB: Analytic, AICPA FC: Risk Assessment, Analysis and Management

Solution: When planning an audit, auditors select audit procedures that are designed to discover material misstatements. Because of time and cost constraints, it would be impractical for an audit to focus on finding all misstatements.

55. Within a U.S. context, the applicable financial reporting framework is typically _____.
A. Generally Accepted Accounting Principles (GAAP)
B. International Standard on Quality Control (ISQC)
C. Auditing and Assurance Standards Board (AASB)
D. International Financial Reporting Standards (IFRS)

Ans: A, LO: 2, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA FC: Measurement Analysis and Interpretation

Solution: Within a U.S. context, the applicable financial reporting framework is typically generally accepted accounting principles (GAAP).

56. Which two audits does an integrated audit combine?
A. A financial statement audit and an audit of the effectiveness of ICFR
B. A financial statement audit and a compliance audit
C. A compliance audit and an audit of the effectiveness of ICFR
D. A performance audit and an environmental audit

Ans: A, LO: 2, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA FC: Measurement Analysis and Interpretation

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Solution: An integrated audit is an audit that combines the financial statement audit with an audit of the effectiveness of ICFR.

57. The audit related to which of the following is specifically meant to express an opinion on the effectiveness of the company's system of internal controls over financial reporting?
A. ICFR
B. GAAP
C. FASB
D. AICPA

Ans: A, LO: 2, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA FC: Measurement Analysis and Interpretation

Solution: Public companies in the U.S. are also required to have an audit of internal controls over financial reporting (ICFR). The objective in an audit of ICFR is to express an opinion on the effectiveness of the company's system of internal controls over financial reporting (AS 2201.03) following section 404(b) of the Sarbanes Oxley Act of 2002.

58. Which audit involves gathering evidence to determine whether the person or entity under review has followed the rules, policies, procedures, laws and regulations with which they must conform?
A. A compliance audit
B. A performance audit
C. An integrated audit
D. An internal audit

Ans: A, LO: 2, Bloom: C, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA FC: Measurement Analysis and Interpretation

Solution: A compliance audit involves gathering evidence to determine whether the person or entity under review has followed the rules, policies, procedures, laws and regulations with which they must conform.

59. What is a compliance audit?
A. an audit to determine whether the entity has conformed with regulations, rules or processes
B. an assessment of the economy, efficiency and effectiveness of an organization's operations
C. an evaluation and improvement of risk management, internal control procedures and elements of the governance process
D. an assessment of the company's financial statements

Ans: A, LO: 2, Bloom: C, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA FC: Measurement Analysis and Interpretation

Solution: A compliance audit is an audit to determine whether the entity has conformed to regulations, rules, or processes.

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60. What is the applicable financial reporting framework in the U.S. known as?
    A. GAAP
    B. GAAS
    C. IFRS
    D. The Internal Revenue Code

Ans: A, LO: 2, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Analytic, AICPA FC: Reporting

Solution: GAAP is the applicable financial reporting framework in the U.S.

61. Public companies, or issuers, in the U.S. are _____.
    A. required by the federal government to have quarterly financial statement audits
    B. required by the federal government to have annual financial statement audits
    C. required by the federal government to have semi-annual financial statement audits
    D. not required by the federal government to have financial statement audits

Ans: B, LO: 2, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Analytic, AICPA FC: Reporting

Solution: Public companies in the U.S. are required to have annual financial statement audits.

62. Private companies, or non-issuers, in the U.S. are _____.
    A. required by the federal government to have quarterly financial statement audits
    B. required by the federal government to have annual financial statement audits
    C. required by the federal government to have semi-annual financial statement audits
    D. not required by the federal government to have financial statement audits

Ans: D, LO: 2, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Analytic, AICPA FC: Reporting

Solution: Private companies in the U.S. are not required by the federal government to have financial statement audits.

63. Which of the following statements is true?
    A. Often interested users, like banks, ask private companies or non-users to provide audited financial statements.
    B. Public users are required to have three audits a year.
    C. Public users are required to have an audit of internal financial forecast reports (IFFRs).
    D. For efficiency purposes, the three required audits for public companies are performed at the same time.

Ans: A, LO: 2, Bloom: C, Difficulty: Easy, Min: 1, AACSB: Analytic, AICPA FC: Reporting

Solution: Often interested users, like banks, ask private companies or non-users to provide audited financial statements.

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64. ICFR stands for:
A. internal controls over financial reporting.
B. internal controls for reporting.
C. international controls over financial reporting.
D. internal controls over forecast reports.

Ans: A, LO: 2, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Analytic, AICPA FC: Reporting

Solution: ICFR stands for internal control over financial reporting.

65. The limitations of an audit are NOT caused by _____.
A. the nature of financial reporting.
B. the nature of audit procedures.
C. the need for the audit to be conducted within a reasonable period of time at a reasonable cost.
D. a guarantee that the financial statements are free from error

Ans: D, LO: 2, Bloom: C, Difficulty: Easy, Min: 1, AACSB: Analytic, AICPA FC: Reporting

Solution: Limitations of an audit are caused by the nature of financial reporting, the nature of audit procedures, and the need for an audit to be conducted within a reasonable period of time.

66. The nature of audit procedures refers to the _____.
A. reliance on evidence provided by the client and its management
B. use of judgment when preparing financial statements due to the subjectivity required when arriving at accounting estimates
C. materiality of misstatement
D. pressures auditors face to complete their audit within a certain time frame at a reasonable cost

Ans: A, LO: 2, Bloom: C, Difficulty: Easy, Min: 1, AACSB: Analytic, AICPA FC: Reporting

Solution: The nature of audit procedures refers to the reliance on evidence provided by the client and its management.

67. A financial statement audit is conducted to _____.
A. enhance the reliability and credibility of the information included in the financial statements
B. guarantee that the financial statements are free from error or fraud
C. determine whether financial documents were altered by those committing a fraud
D. focus on finding all misstatements in the financial records

Ans: A, LO: 2, Bloom: C, Difficulty: Easy, Min: 1, AACSB: Analytic, AICPA FC: Reporting

Solution: A financial statement audit is conducted to enhance the reliability and credibility of the information included in the financial statements.

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68. An integrated audit refers to two audits performed at the same time, or _____.
A. an audit on the effectiveness of internal controls and an audit of the financial statements for external purposes.
B. an internal audit and an external audit with the same identical objectives.
C. an audit for intentional material misstatements and an audit for errors.
D. an audit based on time constraints and an audit based on cost constraints.

Ans: A, LO: 2, Bloom: C, Difficulty: Easy, Min: 1, AACSB: Analytic, AICPA FC: Reporting

Solution: An integrated audit refers to an audit on the effectiveness of internal controls and an audit of the financial statements for external purposes.

69. The nature of audit procedures can refer to the concept of _____.
A. consistency
B. timeliness
C. effectiveness
D. materiality

Ans: D, LO: 2, Bloom: C, Difficulty: Easy, Min: 1, AACSB: Analytic, AICPA FC: Reporting

Solution: The nature of audit procedures can refer to the concept of materiality.

70. Pressures of time and money may affect the audit due to all of the following EXCEPT _____.
A. clients want to issue their financial statements by a certain date
B. clients refusing to pay additional fees for additional audit effort and time
C. pressures within the CPA firm to complete all audits on a timely basis to avoid incurring costs that may not be recovered
D. pressures by shareholders to find all misstatements in the financial reports

Ans: D, LO: 2, Bloom: C, Difficulty: Easy, Min: 1, AACSB: Analytic, AICPA FC: Reporting

Solution: Pressures by shareholders to find all misstatements in the financial reports do not affect the pressures of time and money in and audit.

71. What type of audit involves gathering evidence to determine whether the person or entity under review has followed the rules?
A. A compliance audit
B. An operational audit
C. A financial statement audit
D. An integrated audit

Ans: A, LO: 2, Bloom: C, Difficulty: Easy, Min: 1, AACSB: Analytic, AICPA FC: Reporting

Solution: A compliance audit involves gathering evidence to determine whether a person or entity under review has followed the rules.

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72. What type of audit is concerned with the economy, efficiency and effectiveness of an organization's activities?
A. A compliance audit
B. An operational audit
C. A financial statement audit
D. An integrated audit

Ans: B, LO: 2, Bloom: C, Difficulty: Easy, Min: 1, AACSB: Analytic, AICPA FC: Reporting

Solution: An operational audit is concerned with the economy, efficiency and effectiveness of an organization's activities.

73. What type of audit provides an opinion by the auditor about whether the financial statements are presented fairly in accordance with an applicable financial reporting framework?
A. A compliance audit
B. An operational audit
C. A financial statement audit
D. An audit on the effectiveness of ICFR

Ans: C, LO: 2, Bloom: C, Difficulty: Easy, Min: 1, AACSB: Analytic, AICPA FC: Reporting

Solution: A financial statement audit provides an opinion about whether the financial statements are presented fairly in accordance with an applicable financial reporting framework.

74. What type of audit is conducted to provide assurance about various aspects of an organization's activities rather than the reliability of financial statements? a(an)
A. compliance audit
B. operational audit
C. financial statement audit
D. internal audit

Ans: D, LO: 2, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Analytic, AICPA FC: Reporting

Solution: An internal audit is conduced to provide assurance about various aspects of an organization's activities.

75. Those charged with governance are the _____.
A. CEO, CFO, and COO
B. board of directors and management of an entity
C. stockholders
D. auditors

Ans: B, LO: 2, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Analytic, AICPA BB: Governance Perspective

Solution: The board of directors and management of an entity are those charged with governance.

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76. In the United States, what entities are required by the federal government to have an annual financial statement audit?
A. public companies or issuers
B. private companies or issuers
C. public companies or non-issuers
D. private companies or non-issuers

Ans: A, LO: 2, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA FC: Measurement Analysis and Interpretation

Solution: Public companies, or issuers, in the U.S. are required by the federal government to have an annual financial statement audit. Private companies, or non-issuers, are not required by the U.S. government to have an annual financial statement audit, but often other interested users request that a private company provide audited financial statements.

77. Who among the following users of the financial statement of a company may be particularly interested in evaluating whether the company is paying a fair amount of taxes given its reported earnings, and to gain a better understanding of the company's activities?
A. Government
B. General pubic
C. Employees
D. Investors

Ans: A, LO: 3, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Analytic, AICPA FC: Measurement Analysis and Interpretation

Solution: Governments may read financial statements to determine whether the company is complying with regulations, to evaluate if the company is paying a fair amount of taxes given its reported earnings, and to gain a better understanding of the company's activities. A company in receipt of government grants often must provide a copy of its audited financial statements when applying for a grant and when reporting on how grant funds have been spent.

78. Since users of financial statements make financial decisions that have real consequences, it is very important that users can depend on the information contained in the financial statements. What term captures this problem?
A. reliability
B. competing incentives
C. complexity
D. remoteness

Ans: A, LO: 3, Bloom: C, Difficulty: Easy, Min: 1, AACSB: Analytic, AICPA FC: Measurement Analysis and Interpretation

Solution: Financial statement users are concerned with the reliability of the information contained in the financial statements. Since they use that information to make decisions that have real consequences, it is very important that users can rely on the information contained in the financial statements.

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79. Most financial accounting and disclosure choices being made by the company are complicated and often require significant technical knowledge and experience in order to understand. What term captures this problem?
    A. Complexity
    B. Remoteness
    C. Competing incentives
    D. Reliability

    Ans: A, LO: 3, Bloom: C, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA FC: Measurement Analysis and Interpretation

    Solution: Financial statements are complex, the amounts are often affected by significant estimates, and the disclosures often require significant knowledge and experience to evaluate. Most financial statement users do not have the accounting and legal knowledge to assess the reasonableness of complex accounting and disclosure choices being made by the company.

80. Among the reasons why users demand an audit of financial statements, what is the problem of competing incentives?
    A. The company has a reason to disclose information in a way that presents it in favorable light.
    B. Financial statement users lack accounting and legal knowledge to understand accounting and disclosure choices.
    C. Financial statement users to not have access to the company under review and thus face difficulty in determining whether the statements are fair.
    D. Financial statement users need reliable information in order to make decisions that have real consequences.

    Ans: A, LO: 3, Bloom: C, Difficulty: Easy, Min: 1, AACSB: Analytic, AICPA PC: Communication

    Solution: Company managers have an incentive to disclose the information contained in the financial statements in a way that presents their performance in the best possible light. Users may find it difficult or impossible to identify when management is presenting biased information.

81. Windy is preparing to enter into a University but has not decided yet what course to take. Windy's parents, who are both certified public accountants (CPA), provided a suggestion for Windy to study towards becoming an auditor. However, Windy is not knowledgeable about the work of an auditor and what drives the demand for audit services in the real business world. Which among the following is a valid explanation about the demand for audit and assurance services?
    A. Audit services are in demand among private companies since auditors help in the preparation of their financial statements in an efficient manner.
    B. More and more companies engage the work of audit firms because of the ease in obtaining the signature of certified public accountants as a sign that their financial statements are credible.

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C. Audit services are in demand because the main output of an audit is to provide guidance to companies on how they should run their businesses.
D. Considering that financial statements can be complex, auditors can help the different users of the financial statements to assess the reasonableness of the information presented therein.

Ans: D, LO: 3, Bloom: AN, Difficulty: Medium, Min: 1, AACSB: Analytic, AICPA FC: Risk Assessment, Analysis and Management

Solution: Most financial statement users do not have the accounting and legal knowledge to assess the reasonableness of complex accounting and disclosure choices being made by the company so auditors can help in this assessment.

82. Bloom is one of the junior auditors tasked to perform a financial statement audit for Radon Company. Bloom was having a meeting with the members of the audit team to refresh their understanding on their responsibilities as auditors. Bloom was somehow confused as Bloom's previous work before joining the audit firm was a preparer of financial statements. Which of the following is a responsibility of an auditor and not of a preparer?
A. to make sure that the financial statements present information in accordance with the applicable financial reporting framework
B. to design, implement, and maintain internal controls relevant to the fair presentation of financial statements
C. make estimates for some financial statement items and select the appropriate accounting policies for the presentation of the financial statements
D. seek evidence to corroborate or confirm information provided in the financial statements

Ans: D, LO: 4, Bloom: AN, Difficulty: Medium, Min: 1, AACSB: Analytic, AICPA FC: Risk Assessment, Analysis and Management

Solution: Auditors maintain a questioning mind and thoroughly investigate all evidence presented by their client. Auditors must seek independent evidence to corroborate, or confirm, information provided by their client.

83. Which of the following falls within the purview of financial accounting?
A. Changes in equity
B. Management consulting
C. Business valuation
D. Mergers and acquisitions

Ans: A, LO: 4, Bloom: C, Difficulty: Easy, Min: 1, AACSB: Analytic, AICPA FC: Measurement Analysis and Interpretation

Solution: Financial accounting looks into statements that include the balance sheet (statement of financial position), income statement (statement of comprehensive income), statement of cash flows, statement of changes in equity and accompanying notes.

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84. Which of the following comes under the purview of the Public Company Accounting Oversight Board?
A. Auditing Standards (AS)
B. Statements on Auditing Standards (SAS)
C. Statements on Standards for Attestation Engagement (SSAE)
D. Statements on Quality Control Standards (SQCS)

Ans: A, LO: 5, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective

Solution: Standards issued by the PCAOB are called Auditing Standards (AS), which provide minimum requirements and guidance for auditing services.

85. Which of the following is a private professional membership organization of CPAs representing the accounting profession?
A. AICPA
B. PCAOB
C. ASB
D. IAASB

Ans: A, LO: 5, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective

Solution: The AICPA is a private professional membership organization of CPAs representing the accounting profession. There are over 430,000 members in 137 countries (www.aicpa.org).

86. Which act created the Public Company Accounting Oversight Board, which oversees the audits of public companies?
A. The SOX Act of 2002
B. The Securities Act of 1933
C. The Securities Exchange Act of 1934
D. The Companies Act 2006

Ans: A, LO: 5, Bloom: C, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective

Solution: The SOX Act of 2002 created the Public Company Accounting Oversight Board, or PCAOB, which oversees the audits of public companies.

87. The responsibility for creating and grading the Uniform CPA Exam lies with the _____.
A. AICPA
B. COSO
C. FASB
D. IAASB

Ans: A, LO: 5, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective

Solution: The AICPA is responsible for creating and grading the Uniform CPA Exam.

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88. Which of the following is true of the PCAOB?
A. It can impose punishment on accounting firms that do not adhere to standards.
B. Prior to its creation, the audit profession was highly unregulated.
C. In 2015, it reorganized its auditing standards using several numbering systems.
D. When it was created, it rejected nearly all the then standards of the audit profession.

Ans: A, LO: 5, Bloom: C, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective

Solution: The PCAOB has disciplinary authority over registered firms and can impose punishment on accounting firms that do not adhere to standards. Punishments can include revoking a firm's registration, monetary fines, and banning an individual from auditing public companies.

89. Arwen is an accounting student who is currently studying the different regulators and organizations which are involved in the audit profession. This was the first time Arwen encountered most of these organizations and was having a difficulty in understanding the differences that each role plays. Which among the following statements mostly relates to COSO?
A. maintains the authoritative standards of financial reporting recognized by other regulators and organizations for the audit profession
B. focuses on providing guidance to management and expertise in the areas of internal control, enterprise risk management, and fraud deterrence
C. represents the accounting profession before rule-making bodies and is responsible for grading the Uniform CPA Exam
D. oversees the audits of public companies to protect the interests of users of the financial statements such as investors

Ans: B, LO: 5, Bloom: AN, Difficulty: Medium, Min: 1, AACSB: Analytic, AICPA FC: Risk Assessment, Analysis and Management

Solution: COSO is an independent private-sector group that focuses on providing guidance to management and expertise in the areas of internal control, enterprise risk management, and fraud deterrence.

90. If the auditors do not have access to all the information relevant to the audit, this is known as a(an) _____.
A. material misstatement
B. limitation in scope
C. estimate
D. sampling technique

Ans: B, LO: 6, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Analytic, AICPA FC: Reporting

Solution: A limitation in scope occurs when the auditors do not have access to all the information relevant to the audit.

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91. Eagle, the assigned auditor for Shelob Company, was having a discussion with the client's representative. This was the first time that Shelob will have its financial statements audited by an external party. During the discussion, Shelob wanted to know what is the best-case scenario regarding the opinion which Eagle can issue as a result of the financial statement audit. What is the best explanation on what a reasonable assurance is?
    A. Reasonable assurance is a high level of assurance that there are no material misstatements though not absolute.
    B. Reasonable assurance means that the financial statements are 100% accurate.
    C. Reasonable assurance is a high level of assurance that material misstatements are probable though not detected.
    D. Reasonable assurance is subjective and will depend on the agreement between the auditor and client in terms of its interpretation.

    Ans: A, LO: 6, Bloom: AN, Difficulty: Medium, Min: 1, AACSB: Analytic, AICPA FC: Risk Assessment, Analysis and Management

    Solution: Reasonable assurance is a high, but not absolute, level of assurance. In other words, the auditor does not "guarantee" or "certify" that the financial statements are 100% accurate because that is considered absolute assurance, which is not possible with content that is subjective.

92. Win, who is the audit engagement partner for the audit of Pippin Company, was having an argument with the client's representative. The discussion transpired due to a misunderstanding regarding the term reasonable assurance as the client interpreted it as providing a guarantee that financial statements are free from all errors and misstatements. The client is asking Win the reasons why only reasonable assurance can be attained. What should Win provide as the most appropriate explanation?
    A. The audit team cannot provide absolute assurance as this will be a risk on the audit firm's reputation if later on a material misstatement is discovered.
    B. Absolute assurance is currently not attainable based on the fee agreed for this engagement though amenable upon further discussion of the fee.
    C. Absolute assurance cannot be attained as the audit is time bound and they are not in a position to audit 100% of Pippin's accounts and transactions.
    D. The audit team cannot provide an absolute assurance because the auditors are expected to commit mistakes when conducting the audit.

    Ans: C, LO: 6, Bloom: AN, Difficulty: Medium, Min: 1, AACSB: Analytic, AICPA FC: Risk Assessment, Analysis and Management

    Solution: An audit could not be completed in a reasonable amount of time if auditors had to provide absolute assurance. For some accounts and transactions, auditors use sampling techniques when gathering audit evidence and therefore do not examine 100% of a company's transactions for the period under audit.

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93. Which statement is correct as to financial statement audit reports for public versus private companies?
   A. There is a standard report for the audit of public company financial statements and a standard report for the audit of private company financial statements.
   B. There is a standard report for the audit of public company financial statements but none for auditing private company financial statements.
   C. There is a standard report for the audit of private company financial statements but none for auditing public company financial statements.
   D. There is no distinction between standard reports for the audit of financial statements, regardless of whether the company is private or public.

   Ans: A, LO: 6, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA FC: Reporting

   Solution: There is a standard report for the audit of public company financial statements and a standard report for the audit of private company financial statements.

94. In an unqualified audit report on the financial statements of a public company, what does the first statement of the opinion paragraph state?
   A. An audit was conducted, which financial statements were audited, and the dates of the financial statements.
   B. PCAOB audit standards were followed since it is a public company.
   C. The audit firm believes that its audit provides a reasonable basis for its opinion.
   D. Management is responsible for the fair presentation of the financial statements.

   Ans: A, LO: 6, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA FC: Reporting

   Solution: In the opinion paragraph, the first sentence explains that an audit was conducted and identifies the financial statements and the dates of the financial statements. The second sentence states the auditor's opinion.

95. With regard to financial statements, the auditor is required to obtain *reasonable assurance,* which is a level of assurance that is _____.
   A. high, but not absolute
   B. guaranteed, but not absolute
   C. 100%, but not objective
   D. objective, and not subjective

   Ans: A, LO: 6, Bloom: C, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA FC: Reporting

   Solution: The auditor is only required to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error. Reasonable assurance is a high, but not absolute, level of assurance (AU-C 200.06). In other words, the auditor does not "guarantee" or "certify" that the financial statements are 100% accurate because that is considered absolute assurance which is not possible with content that is subjective.

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96. When auditors determine that the financial statements of a private firm are presented fairly in accordance with the applicable financial reporting framework, they issue the standard _____ report, which is often referred to as a "_____" report.
A. unmodified, clean
B. qualified, clean
C. modified, rough
D. unqualified, rough

Ans: A, LO: 6, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA FC: Reporting

Solution: If auditors have determined the financial statements are presented fairly in accordance with the applicable financial reporting framework, they issue the standard *unmodified* report. The unmodified report is often referred to as a "clean" report.

97. In an audit report on the effectiveness of ICFR for a public company, what does the Opinion on Internal Control over Financial Reporting paragraph explain?
A. The auditors conducted their audit in accordance with the standards of the PCAOB.
B. An internal control system does not eliminate all risk associated with the preparation of financial statements.
C. A material misstatement of the financial statements will not be prevented or detected on a timely basis.
D. Circumstances may change in the future and render controls ineffective if the controls are not modified appropriately.

Ans: A, LO: 7, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Communication, AICPA BB: Governance Perspective

Solution: In an audit report on the effectiveness of ICFR for a public company, the Opinion on Internal Control over Financial Reporting paragraph explains that auditors conducted their audit in accordance with the standards of the PCAOB. In brief terms, it explains the process of conducting an audit of the effectiveness of ICFR.

98. In an audit report on the effectiveness of ICFR for a public company, which paragraph cautions not to use the current year opinion to assume that future internal controls will be effective?
A. definition and inherent limitations paragraph
B. scope paragraph
C. opinion paragraph
D. paragraph referencing the financial statement audit

Ans: A, LO: 7, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Communication, AICPA BB: Governance Perspective

Solution: The final sentence of the definition and inherent limitations paragraph cautions not to use the current year opinion to assume that future internal controls will be effective.

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99. In an audit report on the effectiveness of ICFR for a public company, what does the definition and inherent limitations paragraph provide?
A. definition of ICFR that is taken directly from PCAOB AS 2201
B. indication that the firm is registered with the PCAOB
C. different responsibilities of management and auditors
D. process of conducting an audit of the effectiveness of ICFR

Ans: A, LO: 7, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Communication, AICPA BB: Governance Perspective

Solution: In an audit report on the effectiveness of ICFR for a public company, the definition and inherent limitations paragraph provides a definition of ICFR that is taken directly from PCAOB AS 2201.

100. In an audit report on the effectiveness of ICFR for a public company, to what does the basis of opinion paragraph make a reference?
A. Registration with the PCAOB and independence requirements of the SEC and other federal securities laws
B. The financial statement audit report and the type of opinion that was given on the financial statements.
C. The COSO *Internal Control-Integrated Framework* as the criteria used as the basis for determining if ICFR are effective.
D. A definition of ICFR that is taken directly from PCAOB AS 2201.

Ans: A, LO: 7, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Communication, AICPA BB: Governance Perspective

Solution: In an audit report on the effectiveness of ICFR for a public company, the basis for opinion paragraph states the different responsibilities of management and auditors. Like the audit report on the financial statements, this paragraph references registration with the PCAOB and independence requirements of the SEC and other federal securities laws.

101. Which of the following is the discovery of material weakness?
A. conclusion that the company did not maintain effective ICFR over the period under audit.
B. risk that an auditor expresses an inappropriate audit opinion when the financial statements are materially misstated.
C. identification of accounts and related assertions most at risk of material misstatement.
D. high, but not absolute, level of assurance in a judgment about matters that are subjective.

Ans: A, LO: 7, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Communication, AICPA BB: Governance Perspective

Solution: If auditors conclude the company did not maintain effective ICFR over the period under audit, it would mean the auditors discovered a material weakness in the client's ICFR.

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102. If auditors conclude the company did *not* maintain effective ICFR over the period under audit, it would mean the auditors discovered a/an _____ in the client's ICFR.
A. material weakness
B. audit risk
C. reasonable assurance
D. professional skepticism

Ans: A, LO: 7, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Communication, AICPA BB: Governance Perspective

Solution: If auditors conclude the company did not maintain effective ICFR over the period under audit, it would mean the auditors discovered a material weakness in the client's ICFR.

103. Bright was assigned as the auditor of Elendil Company, a public company engaged in the production of environment-friendly cars made out of wooden materials and is considered as an Accelerated Filer as per SEC. Bright explained to the client's representatives that aside from the financial statement audit, the audit team is also required to produce an audit report on the internal controls over financial reporting of Elendil. However, this was questioned by Elendil's representative as they do not understand the reason behind. Which of the following statements provide the reason why audit of ICFR is necessary?
A. The audit team needs to conduct the audit of ICFR as an effective ICFR will mean that they need not conduct a financial statement audit for efficiency purposes.
B. Audit of ICFR is required because an effective ICFR provides reasonable assurance on the reliability of financial reporting for external purposes.
C. Conducting an audit of ICFR is required because every public company is prone to have poor internal controls in detecting fraud.
D. The audit team needs to conduct an audit of ICFR so they can provide Elendil with suggestions on how they can improve their internal controls over financial reporting.

Ans: B, LO: 7, Bloom: AN, Difficulty: Medium, Min: 1, AACSB: Analytic, AICPA FC: Risk Assessment, Analysis and Management

Solution: The reason for requiring an audit of internal controls is because effective ICFR provides reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes.

104. Starry, the assigned audit engagement partner for Forlong Company, was preparing for an important meeting with the client's representative. This meeting is aimed to address the overall expectation gap between the financial statement users and the auditors. Which of the following should not be considered as an expectation gap for the audit?
A. The auditor will audit all of the accounts and transactions of Forlong Company to provide an absolute assurance.

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B. The auditor, as a result of a successful audit, guarantees the future viability of Forlong Company.
C. The procedures to be performed by the audit team will definitely find any and all fraud inside Forlong Company.
D. The audit team has the necessary skills and knowledge to properly conduct the audit in accordance with the auditing standards.

Ans: D, LO: 7, Bloom: AN, Difficulty: Medium, Min: 1, AACSB: Analytic, AICPA FC: Risk Assessment, Analysis and Management

Solution: It is correct for the financial statement users to expect auditors to have the necessary skills and knowledge to properly conduct the audit in accordance with the auditing standards.

105. The audit expectation gap is narrowed by realistic user expectations such as that the auditor _____.
A. tests a sample of transactions
B. is providing complete assurance
C. is guaranteeing the future viability of the entity
D. will definitely find any and all fraud

Ans: A, LO: 8, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Communication, AICPA FC: Reporting

Solution: One of the many realistic expectations that we must have of auditors is that the auditor does not check all transactions but only a sample of transactions.

106. The audit expectation gap occurs when there is a difference between the expectations of the _____.
A. auditors and financial statement users
B. auditors and review
C. company under review and financial statement users
D. generally accepted accounting principles and auditors

Ans: A, LO: 8, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Communication, AICPA FC: Reporting

Solution: The audit expectation gap occurs when there is a difference between the expectations of auditors and financial statement users.

107. Which of the following beliefs will narrow the audit expectation gap?
A. There is no guarantee the auditor will find all material fraud, should fraud have occurred.
B. The auditor is providing complete assurance.
C. The auditor is guaranteeing the future viability of the entity.
D. An unmodified audit opinion is an indicator of complete accuracy of the financial statements.

Ans: A, LO: 8, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Communication, AICPA FC: Reporting

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Solution: The audit expectation gap will narrow with the awareness that the auditor will assess the risk of fraud and conduct tests to try to uncover any fraud, but there is no guarantee the auditor will find all material fraud, should one have occurred.

108. Economic conditions impact _____.
A. financial statement user's expectations
B. auditor performance
C. both financial statement user's expectations and auditor performance
D. neither financial statement user's expectations not auditor performance

Ans: A, LO: 8, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Communication, AICPA FC: Reporting

Solution: The economic conditions impact financial statement user's expectations.

109. Legislation impacts _____.
A. auditor performance
B. financial statement user's expectations
C. both financial statement user's expectations and auditor performance
D. neither financial statement user's expectations not auditor performance

Ans: A, LO: 8, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Communication, AICPA BB: Governance Perspective

Solution: Legislation impacts auditor performance.

110. Education of financial statement users as to the responsibilities of preparers and auditors of financial statements will _____.
A. reduce the audit expectation gap
B. ensure the auditor will find all material fraud
C. guarantee the future viability of the entity
D. increase audit firm reputation and independence

Ans: A, LO: 8, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Communication, AICPA FC: Reporting

Solution: Education of financial statement users as to the responsibilities of preparers and auditors of financial statements will reduce the audit expectation gap.

Question Type: Text Entry

111. In the context of auditing and assurance standards, _____ are the most specific and narrow.

Ans: Audit services | Assurance services, LO: 1, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Communication, AICPA FC: Reporting

Solution: The relationship of assurance, attestation, and auditing services resembles overlapping umbrellas. Audit services are the most specific and narrow of the three services.

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112. As attestation services encompass more than just the inspection of historical financial statements, the term _____ is used rather than _____.

Ans: practitioner | auditor, LO: 1, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA FC: Measurement Analysis and Interpretation

Solution: In attestation services, the term practitioner is used rather than auditor because attestation services encompass more than just the audit of historical financial statements.

113. Website security and IT operations are services that come under _____ services but fall outside _____ services.

Ans: assurance | attestation, LO: 1, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA FC: Measurement Analysis and Interpretation

Solution: Assurance services include compilation of historical statements, website security, IT operations, and non-financial information. Attestation services (under the umbrella of assurance services) include review of historical financial statements, review of financial forecast, and examination of internal control.

114. According to Financial Accounting Standards Board (FASB), information that is omitted or misstated could influence decisions that users make on the basis of the financial information of a specific reporting entity; in such a case, information is _____.

Ans: material, LO: 2, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA FC: Measurement Analysis and Interpretation

Solution: The Financial Accounting Standards Board (FASB) defines materiality as follows: Information is material if omitting it or misstating it could influence decisions that users make on the basis of the financial information of a specific reporting entity. (SFAC No. 8, para QC11)

115. The Internal Revenue Service (IRS) may conduct an audit of an individual or a company to determine if tax laws have been followed and the correct amount of tax paid. Thus an income tax audit is the best example of a/an _____.

Ans: compliance audit, LO: 2, Bloom: C, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA FC: Measurement Analysis and Interpretation
Solution: One of the best examples of a compliance audit is an income tax audit. The Internal Revenue Service (IRS) may conduct an audit of an individual or a company to determine if tax laws have been followed and the correct amount of tax paid.

116. _____ are users of financial statements who are particularly interested in the capacity of the company to pay a dividend

Ans: Investors, LO: 3, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Analytic, AICPA FC: Measurement Analysis and Interpretation

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Solution: Investors generally read financial statements to determine whether they should invest in the company. They are interested in the return on their investment and are concerned that the entity will remain a going concern (continue operating) into the foreseeable future. Investors may also be interested in the capacity of the company to pay a dividend. Prospective investors read financial statements to determine whether they should buy shares in the entity.

117. _____ are users of financial statements who are particularly interested in determining whether the company is sufficiently credit worthy.

Ans: Lenders, LO: 3, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Analytic, AICPA FC: Measurement Analysis and Interpretation

Solution: Lenders may read financial statements to determine whether an entity is sufficiently credit worthy to make a loan to the entity and whether it can pay the interest and principal as they come due.

118. _____ relates to the application of relevant training, knowledge, and experience that auditors use while making informed audit decisions in conducting an audit.

Ans: Professional judgment, LO: 4, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Analytic, AICPA FC: Measurement Analysis and Interpretation

Solution: Professional judgment relates to the application of relevant training, knowledge, and experience that auditors use while making informed audit decisions in conducting an audit. Auditors must use their judgment throughout the entire audit. For example, auditors must use judgment when determining if an information source is reliable. They must also use judgment when deciding if enough audit evidence has been gathered to support the audit opinion.

119. _____relates to auditors remaining independent of the entity, its management and its staff when completing the audit work and thoroughly investigating all evidence presented by their client.

Ans: Professional skepticism, LO: 4, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Analytic, AICPA FC: Measurement Analysis and Interpretation

Solution: Professional skepticism means the auditors remain independent of the entity, its management and its staff when completing the audit work. In a practical sense, it means the auditors maintain a questioning mind and thoroughly investigate all evidence presented by their client.

120. The accounting firm CBIZ/Mayer Hoffman McCann PC is one of the _____ firms.

Ans: mid-tier, LO: 4, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Analytic, AICPA BB: Customer Perspective

Solution: Below the Big 4, the next tier of accounting firms is known as the mid-tier. The firms that comprise the mid-tier have a significant presence nationally and most have international affiliations. The mid-tier firms in the U.S. include, among others, Grant Thornton LLP, BDO USA LLP, RSM LLP, CBIZ/Mayer Hoffman McCann PC, and CroweHorwath LLC. These firms service medium-sized and smaller clients.

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121. The paragraph of an unmodified audit report on the financial statements of a private firm explains that an audit was conducted and identifies the financial statements and the date of the financial statements is the _____ paragraph.

Ans: opinion, LO: 6, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA FC: Reporting

Solution: The -opinion paragraph of an unmodified audit report on the financial statements explains that an audit was conducted and identifies the financial statements and the date of the financial statements.

122. In an unmodified audit report on the financial statements of a private firm, the _____ paragraph states that the auditor believes that the financial statements are fairly presented, in all material respects, in accordance with the applicable financial reporting framework.

Ans: opinion, LO: 6, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA FC: Reporting

Solution: In an unmodified audit report on the financial statements of a private firm, the opinion paragraph clearly states the auditor's opinion that the financial statements are fairly presented, in all material respects, in accordance with the applicable financial reporting framework.

123. In the title of an audit report on the effectiveness of ICFR for a public company, the term _____ emphasizes that the auditors are external to the company and therefore can provide an objective opinion.

Ans: independent, LO: 7, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Communication, AICPA BB: Governance Perspective

Solution: In the title of an audit report on the effectiveness of ICFR for a public company, the term "independent" emphasizes that the auditors are external to the company and therefore can provide an objective opinion.

124. In an audit report on the effectiveness of ICFR for a public company, report _____ indicates that the firm is registered with the PCAOB.

Ans: title, LO: 7, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective

Solution: In the title of an audit report on the effectiveness of ICFR for a public company, the term "registered" is required to indicate that the firm is registered with the PCAOB.

125. One of the factors that impacts auditor performance is _____.

Ans: audit standards, ethical standards, regulations, legislation, or firm policy and procedures, LO: 8, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Communication, AICPA FC: Measurement Analysis and Interpretation

Solution: Auditor performance is impacted by audit standards, ethical standards, regulations, legislation, and firm policy and procedures.

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Question Type: Multiple-Selection

126. _____is an assurance service but *not* an attestation service. Select all that apply.
   A. Review of historical financial statements
   B. Compilation of non-financial information
   C. Examination of internal control
   D. Review of a financial forecast

   Ans: B, LO: 1, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA FC: Measurement Analysis and Interpretation

   Solution: Assurance services include compilation of non-financial information, historical statements, website security, and IT operations.

127. When describing assurance, attestation, and audit services, which of the following can be considered a common characteristic among these services? Select all that apply.
   A. An independent accounting firm obtains information prepared by someone else and compares it with a set of criteria.
   B. An independent accounting firm provides a written report discussing the results of the service performed.
   C. An independent accounting firm provides a service that adds credibility to the information making it useful for decision making.
   D. An independent accounting firm provides financial statement users with an opinion on whether financial statements are presented fairly in accordance with an applicable framework.

   Ans: A, B, C, LO: 1, Bloom: AN, Difficulty: Medium, Min: 1, AACSB: Analytic, AICPA FC: Risk Assessment, Analysis and Management

   Solution: Providing an opinion as to whether financial statements are presented fairly in accordance with an applicable financial reporting framework only pertains to audit services in particular.

128. In determining which types of services an independent accounting firm provides, which of the following falls under attestation services? Select all that apply.
   A. audit of historical financial statements
   B. examination of financial forecasts
   C. system organization and control reports
   D. risk advisory services
   E. website security services
   F. agreed-upon procedures

   Ans: A, B, C, F, LO: 1, Bloom: AN, Difficulty: Medium, Min: 1, AACSB: Analytic, AICPA FC: Risk Assessment, Analysis and Management

   Solution: Risk advisory, website security, and data integrity services fall are classified as assurance services but not attestation.

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129. In determining which types of services an independent accounting firm provides, which of the following falls under audit services? Select all that apply.
A. audit of historical financial statements
B. examination of financial forecasts
C. audit of internal controls over financial reporting
D. review of historical financial statements

Ans: A, C, LO: 1, Bloom: AN, Difficulty: Medium, Min: 1, AACSB: Analytic, AICPA FC: Risk Assessment, Analysis and Management

Solution: Examination of financial forecasts and review of historical financial statements are classified as attestation but not audit services.

130. When understanding the differences between review and audit services, which of the following relates to a review rather than an audit? Select all that apply.
A. The practitioner does not provide an opinion on whether the financial statements are presented fairly.
B. The practitioner obtains reasonable assurance about whether the financial statements as a whole are free of material misstatement.
C. It is a less expensive service that can be very useful for smaller private companies.
D. The practitioner expresses limited assurance that no material modifications need to be made to the financial statements.

Ans: A, C, D, LO: 2, Bloom: AN, Difficulty: Medium, Min: 1, AACSB: Analytic, AICPA FC: Risk Assessment, Analysis and Management

Solution: Obtaining reasonable assurance is applicable to audit services rather than review.

131. When discussing the fact that an audit is not a guarantee that the financial statements are free from error or fraud, which of the following can be stated as a limitation of an audit? Select all that apply.
A. the nature of financial reporting
B. the nature of audit procedures
C. the need for the audit to be conducted within a reasonable period of time
D. the need for the audit to be conducted at a reasonable cost

Ans: A, B, C, D, LO: 2, Bloom: AN, Difficulty: Medium, Min: 1, AACSB: Analytic, AICPA FC: Risk Assessment, Analysis and Management

Solution: The limitations of an audit are caused by (1) the nature of financial reporting, (2) the nature of audit procedures, and (3) the need for the audit to be conducted within a reasonable period of time at a reasonable cost (AU-C 200.A49).

132. In understanding the demand for audit and assurance services, which of the following can be considered as a financial statement user? Select all that apply.
A. investors

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B. suppliers
C. customers
D. lenders
E. employees
F. governments
G. general public

Ans: A, B, C, D, E, F, G, LO: 3, Bloom: AN, Difficulty: Medium, Min: 1, AACSB: Analytic, AICPA FC: Risk Assessment, Analysis and Management

Solution: Financial statement users include current and potential investors, suppliers, customers, lenders, employees, governments, and the general public.

133. Which of the following is/are acceptable reasons why financial statement users demand an audit service? Select all that apply.
A. Users do not have access to the company under review.
B. Financial statements are complex and often require significant knowledge and experience to evaluate.
C. Users want to obtain absolute assurance that financial statements are free from error.
D. Users may find it difficult or impossible to identify when management is presenting biased information.
E. Users are concerned with the reliability of the information contained in the financial statements.

Ans: A, B, D, E, LO: 3, Bloom: AN, Difficulty: Medium, Min: 1, AACSB: Analytic, AICPA FC: Risk Assessment, Analysis and Management

Solution: Financial statement users demand an audit of financial statements because of remoteness, complexity, competing incentives, and reliability. Obtaining absolute assurance is not achievable in an audit.

134. In differentiating the role of a preparer versus an auditor, which of the following more closely relates to a preparer? Select all that apply.
A. ensures information in the financial statements complies with the applicable financial reporting framework
B. maintains a questioning mind and thoroughly investigates evidence presented
C. designs, implements, and maintains internal control over financial reporting
D. provides access to all records, documentation, and personnel relevant to the financial statement preparation

Ans: A, C, D, LO: 4, Bloom: AN, Difficulty: Medium, Min: 1, AACSB: Analytic, AICPA FC: Risk Assessment, Analysis and Management

Solution: Maintaining a questioning mind to investigate thoroughly evidence presented is a task of an auditor.

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135. Which of the following is/are regulators and other organizations that impact the audit process and the profession? Select all that apply.
   A. Securities and Exchange Commission (SEC)
   B. Public Company Accounting Oversight Board (PCAOB)
   C. American Institute of Certified Public Accountants (AICPA)
   D. Financial Accounting Standards Board (FASB)
   E. Committee on Sponsoring Organizations of Treadway Commission (COSO)
   F. National Association of State Boards of Accountancy (NASBA)

   Ans: A, B, C, D, E, F, LO: 5, Bloom: AN, Difficulty: Medium, Min: 1, AACSB: Analytic, AICPA FC: Risk Assessment, Analysis and Management

   Solution: The regulators and other organizations that impact the audit process and the profession include the SEC, PCAOB, AICPA, FASB, COSO, and NASBA.

136. In identifying the audit expectation gaps, which of the following pertains to reality of an audit service? Select all that apply.
   A. The auditor has checked all transactions.
   B. An auditor provides reasonable assurance.
   C. An auditor guarantees the future viability of the entity.
   D. The auditor will definitely find any and all fraud.

   Ans: B, LO: 8, Bloom: AN, Difficulty: Medium, Min: 1, AACSB: Analytic, AICPA FC: Risk Assessment, Analysis and Management

   Solution: An auditor only provides reasonable assurance, does not guarantee future viability of the entity, does not guarantee that the auditor will find all material fraud, and tests a sample of transactions.

Question Type: Short Answer

137. Briefly describe the similarities between assurance, attestation, and audit services.

   Ans: The terms assurance, attestation, and auditing are sometimes used interchangeably, but they actually represent different types of services. They are similar in that they all represent a common process of an independent accounting firm taking information prepared by someone else and comparing that information to an established set of criteria. At the end of the service, the independent accounting firm provides a written report about the results of the service performed. This process is important because it adds credibility, or integrity, to the information, which makes it more useful for decision making.

   LO: 1, Bloom: AP, Difficulty: Medium, Min: 1, AACSB: Analytic, AICPA FC: Measurement Analysis and Interpretation

138. In an attestation engagement, what is a CPA engaged to provide?

   Ans: Attestation services are performed when an independent practitioner, or CPA, is engaged to issue a report on subject matter that is the responsibility of another party.

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LO: 1, Bloom: AP, Difficulty: Easy, Min: 1, AACSB: Analytic, AICPA FC: Reporting

139. What is the primary goal of the CPA in performing the attest function?

Ans: The CPA's primary goal is to determine whether the client's assertions are fairly stated.

LO: 1, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Analytic, AICPA FC: Measurement Analysis and Interpretation

140. Briefly describe the focus of each of the following professional engagements:

Ans: 1- Auditing Engagement - financial statements
2- Attestation Engagement - financial information about the entity
3 - Assurance Engagement - any information as requested by the entity

LO: 1, Bloom: AN, Difficulty: Medium, Min: 1, AACSB: Analytic, AICPA FC: Research

141. Wella is a newly-promoted partner in an auditing firm and is currently conducting a training for new-hires. One of the participants wanted to know why a financial statement audit is important and how it adds value to its intended users. What should be Wella's response?

Ans: The purpose of an audit of financial statements is to provide financial statement users with an opinion by the auditor on whether the financial statements are presented fairly in accordance with an applicable financial reporting framework. These audit services enhance the degree of confidence that intended users can place in the financial statements.

LO: 1, Bloom: AN, Difficulty: Medium, Min: 1, AACSB: Analytic, AICPA FC: Research

142. In a financial audit report issued by the audit team, Claudia, the audit team manager, noticed that the terms 'practitioner' and 'auditor' were used interchangeably by the team. What should be the explanation of Claudia why these terms should not be used interchangeably?

Ans: The term 'practitioner' is used for attestation services because these encompass more than just the audit of historical financial statements and internal controls which is more appropriate for the term 'auditor'.

LO: 1, Bloom: AN, Difficulty: Medium, Min: 1, AACSB: Analytic, AICPA FC: Research

143. What is independence and when discussing the difference between assurance, attestation, and audit services, which among these is independence required?

Ans: The term independence is common to audit, attestation, and assurance services. Independence implies that the service is performed by someone who was not involved with the creation of the information and who is objective in the evaluation of the information.

LO: 1, Bloom: AN, Difficulty: Medium, Min: 1, AACSB: Analytic, AICPA FC: Research

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144. Junior, a newly-hired staff of a professional services firm, was having a hard time in choosing which among the services currently being offered by the firm should Junior choose as a specialization. For Junior to have a better decision, how would you describe the differences between financial statement audit, compliance audit, operational audit, and internal audit?

Ans:

- A financial statement audit is to provide financial statement users with an opinion by the auditor on whether the financial statements are presently fairly in accordance with an applicable financial reporting framework, which enhances the degree of confidence that intended users can place in the financial statements.
- A compliance audit involves gathering evidence to determine whether the person or entity under review has followed the rules, policies, procedures, laws, and regulations with which they must conform.
- Operational (performance) audits are concerned with the economy, efficiency, and effectiveness of an organization's activities.
- Internal audits are conducted to provide assurance about various aspects of an organization's activities.

LO: 2, Bloom: AN, Difficulty: Medium, Min: 1, AACSB: Analytic, AICPA FC: Research

145. During a discussion with a potential new client, one of the partners in an audit firm was explaining to the client the process of a financial statement audit. However, as the client was only considered a relatively small business, the client asked if there is a less extensive service than an audit which the partner can offer. What is the best way that the partner can explain what a review is and how it differs from an audit?

Ans: In a review, the auditor does not provide an opinion on whether the interim financial statements are presented fairly. Instead, the auditor would only state if there were any material modifications that should be made for the interim financial statements to be in conformity with the appliable financial reporting framework.

LO: 2, Bloom: AN, Difficulty: Medium, Min: 1, AACSB: Analytic, AICPA FC: Research

146. Explain why the nature of financial reporting is considered a limitation of an audit.

Ans: The nature of audit procedures refers to the reliance on evidence provided by the client and its management. It can be difficult for an auditor to determine whether a fraud has occurred because documents altered by those committing the fraud generally hide evidence. Also, auditors often use sampling techniques when gathering audit evidence. If a sample is not representative of all items available for testing, an auditor may arrive at an incorrect conclusion.

LO: 2, Bloom: AN, Difficulty: Medium, Min: 1, AACSB: Analytic, AICPA FC: Research

147. Explain why the need for a timely audit is considered a limitation of an audit.

Ans: The timeliness and cost of a financial statement audit refer to the pressure auditors face to complete their audit within a certain time frame at a reasonable cost. While it is important that auditors do not omit procedures in an effort to meet time and cost constraints, they may be under some pressure to do so.

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LO: 2, Bloom: AN, Difficulty: Medium, Min: 1, AACSB: Analytic, AICPA FC: Research

148. You were assigned by your manager to conduct an operational audit for a new client. However, this is your first time to conduct this engagement and is not familiar with the relevant terms used in this service. How would you explain the differences between economy, efficiency, and effectiveness?

Ans:
- Economy refers to the cost of inputs, including wages and materials.
- Efficiency refers to the relationship between inputs and outputs, or the use of the minimum number of inputs to achieve a given output.
- Effectiveness refers to the achievement of certain goals or the production of a certain level of outputs.

LO: 2, Bloom: AN, Difficulty: Medium, Min: 1, AACSB: Analytic, AICPA FC: Research

149. You are an accounting professor in a university and is currently teaching accounting to college students. In one of your lessons, a student asked who are the users of financial statements. As a response to your student, who will you mention as users of financial statements and how do they use these?

Ans: Financial statement users include current and potential investors, suppliers, customers, lenders, employees, governments, and the general public.
- Investors generally read financial statements to determine whether they should invest in the company.
- Suppliers may read financial statements to determine whether the company can pay for goods or services supplied.
- In many business-to-business transactions, customers may read financial statements to determine whether a company they rely on is likely to remain a going concern and meet their needs.
- Lenders may read financial statements to determine whether an entity is sufficiently creditworthy to qualify for a loan and whether it can pay the interest and principal as they come due.
- Employees may read financial statements to determine whether the entity can pay their wages or salaries and other benefits (for example, pensions).
- Governments may read financial statements to determine whether the company is complying with regulations, to evaluate if the company is paying a fair amount of taxes given its reported earnings, and to gain a better understanding of the company's activities.
- The general public may read financial statements to determine whether they should associate with the company (for example, as a future employee, customer, or supplier), and to gain a better understanding of the company, what it does, and its plans for the future.

LO: 3, Bloom: AN, Difficulty: Medium, Min: 1, AACSB: Analytic, AICPA FC: Research

150. Sky is a manager in an audit firm and is currently assigned a booth in a job fair to promote their firm to job seekers. A number of job seekers asked Sky what audit and assurances services are and if these are services that companies need nowadays. How should Sky explain what drives the demand for audit and assurance services?

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Ans: There are a number of reasons why some or all of these users would demand an audit of financial statements. These include remoteness of financial statement users, complexity of financial statements, competing incentives which may lead to biased presentation, and reliability of information.

LO: 3, Bloom: AN, Difficulty: Medium, Min: 1, AACSB: Analytic, AICPA FC: Research

151. Hodor is currently seeking his first job in the accounting and auditing field and came across two interesting jobs in Hodor's dream company. One of the roles is a preparer and another is an auditor but Hodor is having a hard time distinguishing between the two. What is the best explanation to Hodor regarding the differences between a preparer and auditor role?

Ans: Preparer responsibility include the following:
- Ensuring the information included in the financial statements is presented fairly and complies with the applicable financial reporting framework, which in the United States is most often GAAP.
- Designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.
- Providing the auditors with access to all records, documentation, and personnel relevant to the preparation and fair presentation of the financial statements, and any additional information the auditors may consider relevant to complete the audit.

Auditor responsibility include the following:
- Conducting the audit in accordance with the appropriate auditing standards.
- Planning and performing the audit with professional skepticism.
- Planning and performing the audit with professional judgment.

LO: 4, Bloom: AN, Difficulty: Medium, Min: 1, AACSB: Analytic, AICPA FC: Research

152. Pricefirecoopers (PFC) is a newly created professional services firm and is in the process of hiring individuals to work for them. The Human Resources department is building up the job description of an auditor but does not know what to indicate. What skills would you recommend to the Human Resources department as ideal for the role of an auditor?

Ans:
- Auditors must have extensive knowledge of accounting and auditing standards.
- Auditors must have good analytical and critical-thinking skills.
- Auditors must possess technology skills, especially in the area of data analytics.

LO: 4, Bloom: AN, Difficulty: Medium, Min: 1, AACSB: Analytic, AICPA FC: Research

153. Identify the different regulators and organizations that affect the audit profession and briefly describe their function.

Ans:
- Securities and Exchange Commission (SEC) – primary task is to enforce and interpret securities laws
- Public Company Accounting Oversight Board (PCAOB) – its mission is to oversee the audits of public companies to protect the interests of investors

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- American Institute of Certified Public Accountants (AICPA) – represents the profession before rule-making bodies, acts as an advocate for the profession before legislative bodies, provides educational materials to its members, and sets ethical standards for the profession. Auditing standards for non-issuers.
- Financial Accounting Standards Board (FASB) – mission is to establish financial accounting and reporting standards for nongovernmental entities with the goal of providing information that is useful for decision making
- Committee on Sponsoring Organizations of the Treadway Commission (COSO) – focuses on providing guidance to management and expertise in the areas of internal control, enterprise risk management, and fraud deterrence
- National Association of State Boards of Accountancy (NASBA) and State Boards of Accountancy – mission is to enhance the effectiveness and advance the common interests of its members, which are the state boards of accountancy

LO: 5, Bloom: AN, Difficulty: Medium, Min: 1, AACSB: Analytic, AICPA FC: Research

154. Explain the term 'reasonable assurance' as it relates to a financial statement audit.

Ans: Reasonable assurance is a high, but not absolute, level of assurance. In other words, the auditor does not "guarantee" or "certify" that the financial statements are 100% accurate because that is considered absolute assurance, which is not possible with content that is subjective.

LO: 6, Bloom: AN, Difficulty: Medium, Min: 1, AACSB: Analytic, AICPA FC: Research

155. Your client, McCoy Manufacturing, wants an audit so that the management can tell their bank that their financial statements have been certified to be 100% accurate. Explain why you, the auditor, are unable to provide absolute assurance on the accuracy of the financial statements.

Ans: The responsibility of the auditor is to provide an *opinion* on whether the financial statements are presented fairly in accordance with the applicable financial reporting framework. An *opinion* is defined as a judgment about matters that are subjective. The preparation of financial statements is considered somewhat subjective because management must make some estimates and choose between different accounting methods. Therefore, the auditor is only required to obtain **reasonable assurance** about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error. Reasonable assurance is a high, but not absolute, level of assurance (AU-C 200.06). In other words, the auditor does not "guarantee" or "certify" that the financial statements are 100% accurate because that is considered absolute assurance which is not possible with content that is subjective.

LO: 6, Bloom: S, Difficulty: Hard, Min: 3, AACSB: Reflective Thinking, AICPA BB: Governance Perspective

156. You are a college instructor assigned to teach the subject of auditing. During your discussion regarding audit risk, one of the students asked if an audit risk can be completely eliminated when performing a financial statement audit. What is the best response to this question?

Ans: Audit risk can be reduced but not eliminated because of certain limitations of an audit such as the use of sampling and professional judgment. Auditors can only provide reasonable but not absolute assurance.

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LO: 6, Bloom: AN, Difficulty: Medium, Min: 1, AACSB: Analytic, AICPA FC: Research

157. Julia, the audit manager, was approached by the audit team for guidance regarding the appropriate opinion they should issue regarding a particular client. The team had concluded that the financial statements are not presented fairly in accordance with the applicable financial reporting framework but is not sure what type of modified opinion they should issue. How should Julia describe the three types of modified opinion to the team for them to know which one is appropriate?

Ans: The three types of modified opinion are the following:
- Qualified – financial statements are presented fairly, except for the uncorrected departures or the auditor's inability to gather evidence for a material item
- Adverse – financial statements are not presented fairly and should not be relied upon
- Disclaimer of opinion – auditor was not able to gather sufficient appropriate evidence or is not independent and cannot express an opinion

LO: 6, Bloom: AN, Difficulty: Medium, Min: 1, AACSB: Analytic, AICPA FC: Research

158. Below is a sample of the first section of a standard audit report for Gawronski's Hockey Manufacturing Company, a private company. There are two errors in this report. Describe the errors.

Auditor's Report

To the creditors of Gawronski's Hockey Manufacturing Company:

Report on the Financial Statements

We have audited the accompanying financial statements of Gawronski's Hockey Manufacturing Company, which comprises the balance sheets as of December 31, 2022 and 2021, and the related statements of income, changes in equity and cash flows for the years then ended, and the related notes to the financial statements.

Ans: *[1]* Title – the term *independent* is missing in the title of the report
[2] Address – The report is addressed to the creditors of the company rather than the owners or shareholders of the company and to the board of directors, if applicable.

LO: 6, Bloom: E, Difficulty: Hard, Min: 3, AACSB: Analytic, AICPA FC: Reporting

159. Below is a sample of the auditor's responsibility section of a standard audit report for Gawronski's Hockey Manufacturing Company, a private company. There are two errors in this report. Describe the errors.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with generally accepted

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accounting principles. Those standards require that we plan and perform the audit to obtain absolute assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.
We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Ans: Both errors are in the first paragraph
Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with **auditing standards generally accepted in the United States of America.** Those standards require that we plan and perform the audit to obtain **absolute** assurance about whether the financial statements are free from material misstatement.
1) The appropriate audit standards would be those issued by the ASB since the company is a private company.
2) Audits provide reasonable assurance, not absolute.

LO: 6, Bloom: E, Difficulty: Hard, Min: 3, AACSB: Analytic, AICPA FC: Reporting

160. Below is a sample of the auditor's opinion section of a standard audit report for Gawronski's Hockey Manufacturing Company, a private company. There are two errors in this report. Describe the errors.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Gawronski's Hockey Manufacturing Company as of December 31, 2022 and 2021, and the results of its operations and its cash flows for the years then ended in accordance with auditing standards generally accepted in the United States of America.
Keith Christy, Partner
Adrian, Michigan
February 15, 2023

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Ans: **Opinion**
In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Gawronski's Hockey Manufacturing Company as of December 31, 2022 and 2021, and the results of its operations and its cash flows for the years then ended in accordance with **accounting principles** generally accepted in the United States of America.
Christy and Quinlan, LLP
February 15, 2023
1) The financial statements are in accordance with GAAP, not GAAS
2) The firm name is used in the signature, not the individual partner's name

LO: 6, Bloom: E, Difficulty: Hard, Min: 3, AACSB: Analytic, AICPA FC: Reporting

161. The standard "clean" audit reports for audits of public companies have several differences to reports for audits of private companies. Describe at least three of those differences noted in the audit reports for public companies.

Ans: Some differences that may be noted include:
Title -The term *registered* is included to emphasize the firm is registered with the PCAOB.
Paragraph order - The opinion paragraph comes at the beginning of the report, along with other differences in the order of paragraphs
Paragraph referencing the audit of internal control – This paragraph is unique to the public company audit report. Public companies are required to have an audit of ICFR and auditors issue a separate opinion for that audit, which is discussed in the next section.
Basis for opinion paragraph –The private company report goes into more detail regarding the responsibilities of management and auditors. One key difference is this paragraph references registration with the PCAOB and independence requirements of the SEC and other federal securities laws.
Scope paragraph - It includes an explicit statement that PCAOB audit standards were followed since it is a public company.
Auditor tenure – The final component of the report is a sentence that states the year in which the firm began serving consecutively as the company's auditor.

LO: 6, Bloom: E, Difficulty: Hard, Min: 3, AACSB: Analytic, AICPA FC: Reporting

162. Describe the auditor's responsibility regarding the detection of fraud.

Ans: The auditor should design audit procedures that will provide reasonable assurance that the financial statements are free from material misstatement due to errors and/or fraud.

Ans: N/A, LO: 6, Bloom: AN, Difficulty: Medium, Min: 1, AACSB: Ethics, AICPA FC: Risk Assessment, Analysis and Management

163. You are auditing Gray Enterprises, a public company. During the audit, a material weakness was discovered during the audit of internal controls over financial reporting. Discuss how the auditors should handle this situation in the audit report and reference the appropriate PCAOB auditing standard.

Ans: If one or more material weaknesses are discovered during the audit, then auditors issue an *adverse* opinion on the effectiveness of ICFR that explicitly states the company did not maintain effective ICFR during the period under audit. PCAOB AS 2201 dictates how auditors would modify the audit report to express an adverse opinion.

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LO: 7, Bloom: E, Difficulty: Hard, Min: 3, AACSB: Analytic, AICPA FC: Reporting

164. When does an auditor issue an adverse opinion when performing an audit on internal controls over financial reporting?

Ans: If one or more material weaknesses are discovered during the audit, then auditors issue an adverse opinion on the effectiveness of ICFR that explicitly states the company did not maintain effective ICFR during the period under audit.

LO: 7, Bloom: AN, Difficulty: Medium, Min: 1, AACSB: Analytic, AICPA FC: Research

165. Explain the concept of a company's internal control over financial reporting.

Ans: A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

LO: 7, Bloom: AN, Difficulty: Medium, Min: 1, AACSB: Analytic, AICPA FC: Research

166. Explain what is a performance gap and how can it be reduced.

Ans: Performance gap is the difference between auditor performance and auditing standards and regulations. This can be reduced by:
- Auditors performing their duties appropriately, complying with auditing standards, and meeting the minimum standards of performance that should be expected of all auditors.
- Inspections of audits to ensure that auditing standards have been correctly applied.
- Assurance providers reporting accurately the level of assurance being provided.

LO: 7, Bloom: AN, Difficulty: Medium, Min: 1, AACSB: Analytic, AICPA FC: Research

167. Explain what is an expectation gap and how can it be reduced.

Ans: Expectation gap is the difference between a financial statement user's expectations and auditing standards and regulations. This can be reduced by:
- Auditing standards being reviewed and updated on a regular basis to enhance the work being done by auditors.
- Education of financial statement users as to the responsibilities of preparers and auditors of financial statements.

LO: 7, Bloom: AN, Difficulty: Medium, Min: 1, AACSB: Analytic, AICPA FC: Research

168. Smith Corp. orally engaged TRA CPAs, to audit its financial statements. The management of Smith Corp. informed TRA CPAs that it suspected that the accounts receivable was materially overstated. Although the financial statements audited by TRA CPAs did, in fact, include a materially overstated accounts receivable balance, TRA issued an unqualified opinion. Smith Corp then relied on the financial statements in deciding to obtain a loan from Town Bank to expand its operations and Town Bank relied on the financial statements in making the loan to Smith Corp. As a result of the overstated accounts receivable balance, Smith Corp. has defaulted

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on the loan and has incurred a substantial loss. If Smith Corp sues TRA CPAs for negligence in failing to discover the overstatement, what is TRA CPA's best defense?

Ans: TRA CPAs best defense is that the audit was performed by Dex in accordance with generally accepted auditing standards.

LO: 7, Bloom: E, Difficulty: Hard, Min: 3, AACSB: Ethics, AICPA FC: Measurement Analysis and Interpretation

169. You are a staff auditor at Broman, LLP. You have been assigned to an audit engagement with a new intern. The intern mentions the client stated, "he was glad the auditors were there to guarantee the future success of the business so that his lousy banker would get off his back". You explain that the audit firm does not guarantee anything. Explain the audit expectation gap to the intern and provide several ways that the audit expectation gap can be reduced.

Ans: The audit expectation gap occurs when there is a difference between the expectations of auditors and financial statement users. The gap occurs when user beliefs do not align with what an auditor has actually done. In particular, the gap is caused by unrealistic user expectations such as:

- the auditor is providing complete assurance
- the auditor is guaranteeing the future viability of the entity
- an unmodified audit opinion is an indicator of complete accuracy of the financial statements
- the auditor will definitely find any and all fraud
- the auditor has checked all transactions.

The reality is that:

- an auditor provides reasonable assurance
- the audit does not guarantee the future viability of the entity
- an unmodified opinion indicates the auditor believes there are no material misstatements in the financial statements
- the auditor will assess the risk of fraud and conduct tests to try to uncover any fraud, but there is no guarantee the auditor will find all material fraud, should one have occurred
- the auditor tests a sample of transactions.

The audit expectation gap can be reduced by:

- auditors performing their duties appropriately, complying with auditing standards and meeting the minimum standards of performance that should be expected of all auditors
- inspections of audits to ensure that auditing standards have been applied correctly
- auditing standards being reviewed and updated on a regular basis to enhance the work being done by auditors
- education of financial statement users as to the responsibilities of preparers and auditors of financial statements
- assurance providers reporting accurately the level of assurance being provided

N/A, LO: 8, Bloom: S, Difficulty: Hard, Min: 3, AACSB: Analytic, AICPA FC: Reporting

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