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Chapter 2

Professionalism and Professional Responsibilities

Question Type: True or False

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

   Ans: A, LO: 1, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: N/A, AICPA BB: None, AICPA FC: Reporting, AICPA PC: None

   Solution: The cornerstone of the public accounting profession is recognized in the public interest in the work done by CPAs

2. Both licensed tax preparers and CPA professionals have the right to sign tax returns.
   A. True
   B. False

   Ans: A, LO: 1, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: N/A, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: None

   Solution: The right to sign tax returns as a tax preparer is granted to both licensed tax preparers and licensed CPA Professionals.

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

   Ans: B, LO: 1, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: N/A, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: None

   Solution: In the context of an EC Professional, the profession is usually defined by the line of work or occupation.

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

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B. False

Ans: B, LO: 2, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: N/A, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: None

Solution: The rules of AICPA Code of Professional Conduct are applicable to members in public practice, those in business, and others.

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

Ans: B, LO: 2, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: N/A, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: None

Solution: The rules of conduct of the AICPA Code of Professional Conduct establish minimum standards of **acceptable** conduct in the performance of professional services.

6. CPAs must obtain their license from State Boards of Accountancy.
A. True
B. False

Ans: A, LO: 2, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: N/A, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: None

Solution: CPAs must obtain their license from State Boards of Accountancy, irrespective of whether they are members of the AICPA or not.

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

Ans: A, LO: 3, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: N/A, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: None

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

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

Ans: B, LO: 3, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: N/A, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: None

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Solution: In three basic types of safeguards, the first is safeguards created by the profession (e.g., the safeguards suggested in the rules of the code of conduct, legislation, or regulation).

9. CPAs should evaluate identified threats individually only.
   A. True
   B. False

Ans: B, LO: 3, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: None

Solution: CPAs should evaluate identified threats both individually and in aggregate.

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

Ans: B, LO: 4, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: None

Solution: According to the integrity and objectivity rule, a member should be free of conflict of interest.

11. The rule on integrity and objectivity applies to all services performed by CPAs.
   A. True
   B. False

Ans: A, LO: 4, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: None

Solution: The rule on integrity and objectivity applies to all services performed by CPAs, including tax, audit, bookkeeping, and consulting services.

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

Ans: A, LO: 5, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: None

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

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

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Ans: A, LO: 5, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Communication, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: None

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

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

Ans: B, LO: 5, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: None

Solution: A covered member cannot be a trustee of a trust or an executor of an estate who invests in an attest client.

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

Ans: A, LO: 6, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: None

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

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

Ans: B, LO: 6, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: None

Solution: The general standards of the AICPA Code of Professional Conduct apply to all CPAs performing public accounting services.

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

Ans: A, LO: 6, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: None

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

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

Ans: A, LO: 7, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Technology, Learning, AICPA BB: Global and Industry Perspectives Perspective, AICPA FC: Reporting, AICPA PC: None

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

19. Rule 1.500 of the AICPA pertains to confidential information.
A. True
B. False

Ans: B, LO: 7, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: None

Solution: Rule 1.700 of the AICPA pertains to confidential information.

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

Ans: A, LO: 8, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: None

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

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

Ans: A, LO: 8, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: None

Solution: When an embezzlement occurs, the bonding company reimburses the insured (the client) for its losses. Then, under the right of subrogation to the insured's contractual claim, the bonding company can bring suits against the CPA for failing to discover the fraud.

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

    Ans: A, LO: 8, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: None

    Solution: A due care defense is a primary defense against tort actions, as it is for contributory negligence.

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

    Ans: A, LO: 9, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: None

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

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

    Ans: B, LO: 9, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: None

    Solution: The defendant (the auditor) in a Section 18 suit must prove that he or she had no knowledge of the false or misleading statement.

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

    Ans: A, LO: 9, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: None

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

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Question Type: Multiple choice

26. In defining a profession or professional, one common characteristic is _____.
    A. concern for the public interest
    B. self-promotion
    C. effective marketing skills
    D. effective communication skills

    Ans: A, LO: 1, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: None

    Solution: A profession can be defined by a concern for the public interest.

27. CPAs and the accounting profession in general are often defined by a responsibility and concern for the public interest. In order for accountants and CPAs to effectively uphold this concern for the public interest, which of the following must be adhered to?
    A. The CPA must apply effective, impartial judgment at all times, but ultimately submit to management's wishes during an audit.
    B. CPAs should approach any audit objectively and impartially and be cognizant that their primary beneficiary is ultimately the public and the public interest.
    C. Complete optional continuing professional education courses if the CPA so chooses, to learn about new developments in the field.
    D. CPAs must pass a rigorous professional exam, complete an experience requirement, and agree to immediately withdraw from any audit when there is a disagreement between the auditor and management.

    Ans: B, LO: 1, Bloom: Analyze, Difficulty: Medium, Min: 1, AACSB: Analytic, AICPA BB: None, AICPA FC: Reporting, AICPA PC: None

    Solution: CPAs should approach any audit objectively and impartially and be cognizant that their primary beneficiary is ultimately the public and the public interest.

28. Johnson CPA Firm has been assisting a client with tax preparation work. The client is a small business who hired Johnson CPA Firm because they did not have the necessary expertise in-house to file the appropriate and correct tax forms. As the engagement draws to a close, the client requests that Johnson CPA Firm sign the tax report on their behalf. Johnson's most appropriate response in this situation is
    A. to advise the client that under State Board of Accountancy rules, they are not allowed to sign the tax forms, and that the client should sign instead.
    B. to explain to the client that while Johnson can sign the forms, the legal liability for any errors or fraud remains with the client.
    C. to advise the client that Johnson, as a CPA firm, is authorized to sign the tax forms as a tax preparer.

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D. to request the client to take the tax forms to another CPA for review and signing, as it would be a conflict of interest for Johnson to sign off on their own work.

Ans: C, LO: 1, Bloom: Analyze, Difficulty: Medium, Min: 1, AACSB: Analytic, AICPA BB: None, AICPA FC: Reporting, AICPA PC: None

Solution: to request the client take the tax forms to another CPA for review and signing, as it would be a conflict of interest for Johnson to sign off on their own work.

29. External auditors must be extremely careful when interacting with management during an audit, and should maintain independence in appearance and fact at all times, to the greatest extent possible. Which of the following choices best describes the relationship between the external auditors and client management?
A. External auditors should collaborate closely with client management and withdraw immediately if there are any disagreements.
B. External auditors need to be seen as being independent of management, and ensure they are ultimately serving the public interest.
C. Management and the external auditors should preemptively agree on what changes the auditor will make, to ensure management cooperate accordingly.
D. External auditors need to be independent of management in order to guarantee reasonable assurance of no material misstatements in the financial statements.

Ans: B, LO: 1, Bloom: Analyze, Difficulty: Medium, Min: 1, AACSB: Ethics, AICPA BB: None, AICPA FC: Reporting, AICPA PC: None

Solution: External auditors need to be seen as being independent of management, and ensure they are ultimately serving the public interest.

30. Which group licenses CPAs?
A. The FASB
B. The SEC
C. The AICPA
D. The State Boards of Accountancy

Ans: D, LO: 1, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: N/A, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: None

Solution: The State Boards of Accountancy license CPAs.

31. What must CPAs complete to achieve licensure?
A. An application, required education, and pass the CPA Exam.
B. Required education, pass the CPA Exam, and requisite experience requirement.
C. An application, fingerprints, and pass the CPA Exam.
D. A background check, drug test, and pass the CPA Exam.

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Ans: B, LO: 1, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: N/A, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: None

Solution: CPAs must have the required education, pass the exam, and possess the requisite experience.

32. There was public concern about professional auditing in the late 1990s and the 21st century when about _____ of all public companies had to restate their earnings.
A. 8 percent
B. 2 percent
C. 15 percent
D. 30 percent

Ans: A, LO: 1, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: None

Solution: During the late 1990s and the first few years of the 21st century, auditors failed to find many material misstatements on a timely basis, and many times management had to restate earnings due to material misstatements. There was public concern about the quality of professional auditing services when about 8% of all public companies had to restate their earnings in the late 1990s and early 21st Century.

33. According to Chapter 2 regarding professionalism and professional responsibilities, CPI stands for _____.
A. commitment to professional integrity
B. concern for public interest
C. continuing professional interest
D. classified professional intelligence

Ans: B, LO: 1, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

Solution: CPI stands for concern for public interest.

34. Interpretations provide additional guidance regarding the scope and applicability of the _____.
A. rules of conduct
B. standards
C. conceptual framework
D. principles

Ans: A, LO: 2, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: N/A, AICPA BB: Global and Industry Perspectives, AICPA FC: Reporting, AICPA PC: None

Solution: Interpretations provide additional guidance regarding the scope and applicability of the rules of conduct.

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35. One of the defining characteristics of a profession, including the accounting profession, is a code of professional ethics, and a commitment by members to abide by and adhere to this code. Which of the following statements is most accurate pertaining to a code of professional ethics?
    A. As the code is not enforceable, members should ideally attempt to abide by the code of ethics at all times and document any departures from it.
    B. A professional code of ethics which members are strictly required to adhere to enhances investors and the public's confidence in CPAs and the accounting profession.
    C. A code of professional ethics must be practicable but should not be idealistic.
    D. CPAs who abide by the code of professional ethics generally do not affect the reputation of the accounting profession in general.

    Ans: B, LO: 2, Bloom: Analyze, Difficulty: Medium, Min: 1, AACSB: Ethics, AICPA BB: None, AICPA FC: Reporting, AICPA PC: None

    Solution: A professional code of ethics which members are strictly required to adhere to enhances investors and the public's confidence in CPAs and the accounting profession.

36. Many State Boards of Accountancy work with the AICPA on a multitude of professional issues as well as having incorporated the AICPA Code of Professional Conduct into state rules which make them applicable to all CPAs in those states. Which of the following statements best describes the AICPA Code of Professional Conduct?
    A. Rules of conduct are designed to establish optional guidelines for performance of professional services, and interpretations provide additional guidance with respect to applicability and scope of the rules of conduct.
    B. Principles outline the basic tenets of ethical conduct and provide a framework, and rules of conduct establish minimum standards of acceptable conduct.
    C. Principles express basic tenets of ethical conduct and provide a framework, and interpretations provide optional guidance which do not require justifications of departures.
    D. The AICPA bylaws require members adhere to all principles of the AICPA Code of Professional Conduct.

    Ans: B, LO: 2, Bloom: Analyze, Difficulty: Medium, Min: 1, AACSB: Analytic, AICPA BB: None, AICPA FC: Reporting, AICPA PC: None

    Solution: Principles outline the basic tenets of ethical conduct and provide a framework, and rules of conduct establish minimum standards of acceptable conduct.

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37. CPAs and the accounting profession adhere to what is known as the AICPA Code of Professional Conduct. In addition to other guidance for members and CPAs, the code consists of principles, rules of conduct, and interpretations. Which of the following statements is true regarding the AICPA Code of Professional Conduct?
    A. The code of professional conduct is optional; however, CPAs are encouraged to adhere to this code by both the AICPA and State Boards of Accountancy.
    B. Code interpretations have helped to establish minimum standards, requiring a justification by an CPA that departs from these standards.
    C. Code of professional conduct principles are generally considered to be more important than interpretations, and rules of conduct represent the only mandatory part of the code.
    D. A CPA that departs from a rule of conduct and/or an interpretation must be prepared to justify such a departure.

    Ans: D, LO: 2, Bloom: Analyze, Difficulty: Medium, Min: 1, AACSB: Ethics, AICPA BB: None, AICPA FC: Reporting, AICPA PC: None

    Solution: A CPA that departs from a rule of conduct and/or an interpretation must be prepared to justify such a departure.

38. Which of the following components of the AICPA are enforceable?
    A. Rules of conduct
    B. Principles
    C. Interpretations
    D. None of the choices is correct

    Ans: A, LO: 2, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: None

    Solution: The rules of conduct of the AICPA are enforceable, but not the principles or interpretations.

39. The structure of the AICPA _____ includes four major sections: preface, rules for members in public practice, rules for members in business, and rules for other members.
    A. Code of Professional Conduct
    B. Conceptual Framework
    C. Independence Rules
    D. Rules of Conduct

    Ans: A, LO: 2, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: None

    Solution: The AICPA Code of Professional Conduct is organized in four major sections: 1) a preface; 2) rules for members in public practice; 3) rules for members in business; and 4) rules for other members.

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40. Which of the following provides guidance to all members of the AICPA with respect to performance of their professional responsibilities?
    A. Code of Professional Conduct
    B. Rules of Conduct
    C. Principles
    D. Interpretations

    Ans: A, LO: 2, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: None

    Solution: The AICPA Code of Professional Conduct, which includes principles, rules, and interpretations, provides guidance to all members of the AICPA with respect to performance of their professional responsibilities.

41. Which component of the AICPA's Code of Professional Conduct expresses the basic tenets of ethical conduct and provides the framework for the rules that govern the performance of a member's professional responsibilities?
    A. Principles
    B. Rules of Conduct
    C. Interpretations
    D. General standards

    Ans: A, LO: 2, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

    Solution: The principles express the basic tenets of ethical conduct and provide the framework for the rules.

42. Which component of the AICPA's Code of Professional Conduct establishes minimum standards of acceptable conduct in the performance of professional services?
    A. Principles
    B. Rules of Conduct
    C. Interpretations
    D. General standards

    Ans: B, LO: 2, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

    Solution: The Rules of Conduct establish minimum standards of acceptable conduct.

43. Which component of the AICPA's Code of Professional Conduct provides additional guidance regarding the scope and applicability of the rules of conduct?
    A. Principles
    B. Rules of Conduct
    C. Interpretations

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D. General standards

Ans: C, LO: 2, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

Solution: The interpretations provide additional guidance.

44. The AICPA Code of Professional Conduct can be found online and is organized in four sections. Which section is first?
A. Part I on ethical rules.
B. Preface applicable to all members.
C. Introduction to the History of the Code of Conduct.
D. Foreword about AICPA membership.

Ans: B, LO: 2, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

Solution: The preface is the first section of The Code.

45. In the online version of the AICPA Code of Professional Conduct, what are used to make it easy to find related topics?
A. Summaries
B. A series of hyperlinks
C. Outlines
D. Interpretations

Ans: B, LO: 2, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

Solution: Hyperlinks are used in the online version of The Code to make it easy to find related topics.

46. Which section of the AICPA Code of Professional Conduct includes ethical rules for members in business?
A. Part I
B. Part II
C. Part III
D. Some other section

Ans: B, LO: 2, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

Solution: Part II includes ethical rules for members in business.

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

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B. Part II
C. Part III
D. Some other section

Ans: C, LO: 2, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

Solution: Part III of The Code includes ethical rules for other members.

48. Which section of the AICPA Code of Professional Conduct includes ethical rules for members in public practice?
A. Part I
B. Part II
C. Part III
D. Some other section

Ans: A, LO: 2, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

Solution: Part I includes ethical rules for members in public practice.

49. Which component of the AICPA's Code of Professional Conduct is enforceable wherein members must be prepared to justify departures?
A. Principles
B. Rules of Conduct
C. Commitments
D. Standards

Ans: B, LO: 2, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

Solution: The rules are enforceable wherein members must be prepared to justify departures.

50. Which component of the AICPA's Code of Professional Conduct requires that a member who departs from it shall have the burden of justifying the departure in a disciplinary hearing?
A. Principles
B. Standards
C. Commitments
D. Interpretations

Ans: D, LO: 2, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

Solution: A member who departs from the interpretations shall have the burden of justifying the departure.

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51. The AICPA is an accounting organization representing the profession and membership is _____.
A. non-voluntary
B. voluntary
C. free
D. required

Ans: B, LO: 2, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

Solution: Membership in the AICPA is voluntary.

52. State Boards of Accountancy typically _____.
A. work separately from the AICPA on many professional issues
B. work together with the AICPA on many professional issues
C. have separate codes of conduct from the AICPA
D. leave the task of licensure to the AICPA

Ans: B, LO: 2, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

Solution: State boards typically work together with the AICPA on many professional issues.

53. When you pass the CPA exam and then seek licensure, you would apply to _____.
A. AICPA
B. your university
C. NASBA
D. your State Board of Accountancy

Ans: D, LO: 2, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

Solution: You would apply to the State Board of Accountancy.

54. What is a key element that best separates recognized professions from other occupations?
A. Large application fees
B. A commitment to ethical behavior
C. Certifications
D. Specific schooling requirements

Ans: B, LO: 2, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

Solution: A commitment to ethical behavior separates recognized professions from other occupations.

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55. Although codes of ethics may be designed in part to encourage ideal behavior, they must also be _____.
A. practical and enforceable
B. idealistic and above the law
C. easy to remember and basic
D. balanced and confidential

Ans: A, LO: 2, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

Solution: Codes of ethics must also be practical and enforceable.

56. If a CFO of a company is dealing with an ethical situation, which section of the AICPA's Code of Professional Ethics might he/she refer?
A. Part I
B. Part II
C. Part III
D. Some other section

Ans: B, LO: 2, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

Solution: He/she should refer to Part II as a member in business.

57. If a public practice CPA firm is concerned about the ethical nature of the firm's advertising, which section of the AICPA's Code of Professional Ethics would provide guidance?
A. Part I
B. Part II
C. Part III
D. Some other section

Ans: A, LO: 2, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

Solution: Part I would provide guidance to members in public practice.

58. To be meaningful, a code of ethics must strike a balance between being _____.
A. above the law but below the ideal
B. below the law but above the ideal
C. above the law but below practical
D. below the law but above practical

Ans: A, LO: 2, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

Solution: A code of ethics should be above the law but below the ideal.

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59. In which section of the AICPA Code of Professional Conduct could you find the definitions to concepts mentioned in the Code?
A. Part I
B. Part II
C. Part III
D. Preface applicable to all members

Ans: D, LO: 2, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

Solution: Definitions are located in the preface.

60. Which of the following is the threat that, due to a long or close relationship with a client, a CPA will become too sympathetic to the client's interests or too accepting of the client's work or product?
A. Familiarity threat
B. Adverse interest threat
C. Advocacy threat
D. Self-review threat

Ans: A, LO: 3, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Decision Making

Solution: A familiarity threat is the threat that, due to a long or close relationship with a client, a CPA will become too sympathetic to the client's interests or too accepting of the client's work or product.

61. An advocacy threat is the threat that a CPA will _____.
A. promote a client's interests
B. take on the role of client management
C. become too sympathetic to a client's interests
D. not act with objectivity

Ans: A, LO: 3, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Decision Making

Solution: An advocacy threat is the threat that a CPA will promote a client's interests.

62. If a CPA, during the course of an audit, needs to refer to the AICPA Code of Professional Conduct in an attempt to answer a question or resolve a dispute, the CPA should be cognizant of which of the following?
A. The AICPA Code of Professional Conduct is extremely extensive and will be able to provide guidance on any situation or scenario the CPA needs assistance with.
B. While the AICPA Code of Professional Conduct is extensive, it may not address every situation or scenario. In this instance, the CPA should refer to the conceptual framework.

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C. A reasonable and informed third party should be able to conclude, having been made aware of relevant information, that there is no threat to the CPAs compliance with the rules.
D. While the AICPA Code of Professional Conduct is extensive, it may not address every situation or scenario. In this instance, the CPA should refer exclusively to the rules of conduct set forth in the code.

Ans: B, LO: 3, Bloom: Analyze, Difficulty: Medium, Min: 1, AACSB: Ethics, AICPA BB: None, AICPA FC: Reporting, AICPA PC: None

Solution: While the AICPA Code of Professional Conduct is extensive, it may not address every situation or scenario. In this instance, the CPA should refer to the conceptual framework.

63. Sunnyside External Auditors is working on the audit of Transparent Windows Co. The audit client is a relatively small firm who had historically been using a different external auditor. The client has recently apprised the auditor of ongoing litigation, and requested that the external auditor provide expert witness services to assist the client in their dense. In this situation, which of the following should the auditor be aware of?
A. A familiarity threat exists, because the new external auditor has immediately been asked to assist the client in the capacity of an expert witness.
B. A management participation threat exists, as the external auditor in providing expert witness services will be assuming managerial functions.
C. An advocacy threat exists, because in providing expert witness services, the CPAs objectivity may be questionable.
D. An adverse interest threat exists because the CPA is now performing expert witness services and may be cross-examined by the plaintiff and be compelled to provide evidence against the client.

Ans: C, LO: 3, Bloom: Analyze, Difficulty: Medium, Min: 1, AACSB: Ethics, AICPA BB: None, AICPA FC: Reporting, AICPA PC: None

Solution: An advocacy threat exists, because in providing expert witness services, the CPAs objectivity may be questionable.

64. Blue-Sky External Auditors are working on the audit of Timber Company, a large company that specializes in wood and lumber products. During the course of the audit, it has been determined that a former audit manager of Blue-Sky is now employed with Timber Company. Based on this scenario, which of the following types of threats may exist?
A. An advocacy threat may exist because the interests of the former employee who now works for Timber Company may be misaligned with the interests of the external auditor.
B. A management participation threat may exist because the former employee occupies a role in the client's management.

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C. An adverse interest threat likely exists because the former employee of the audit firm will now be placed in a position which will cause a conflict of interest.
D. A familiarity threat may exist because the former employee may have greater knowledge of the policies and practices of the external auditor.

Ans: D, LO: 3, Bloom: Analyze, Difficulty: Medium, Min: 1, AACSB: Ethics, AICPA BB: None, AICPA FC: Reporting, AICPA PC: None

Solution: A familiarity threat may exist because the former employee may have greater knowledge of the policies and practices of the external auditor.

65. Glowbright External Auditors are currently reviewing their audit clients to determine where audit staff, resources and monies should be best allocated. During the course of the review, it has been determined that two clients, both large companies, represent approximately sixty percent of Glowbright's revenue. In this situation, Glowbright should be aware of what type of possible threat?
A. A self-review threat is likely to exist because the auditor is unlikely to remain objective during the course of the audit because the client represents a substantial portion of the auditor's revenues.
B. An undue influence threat may exist because the auditor is more likely to subordinate his or her judgment to employees of a major audit client.
C. A self-interest threat may exist because the client represents a relatively significant portion of the auditors' revenues.
D. A self-interest threat may exist because the auditor is more likely to issue a clean audit opinion to a major audit client.

Ans: C, LO: 3, Bloom: Evaluate, Difficulty: Hard, Min: 1, AACSB: Ethics, AICPA BB: None, AICPA FC: Reporting, AICPA PC: None

Solution: A self-interest threat may exist because the client represents a relatively significant portion of the auditors' revenues.

66. During the audit of Oak Company, a firm that specializes in kitchen cabinetry and other types of furniture, senior management of Oak Company has approached the external auditor and requested assistance with bookkeeping services. Oak does not have the expertise in-house, and is thus requesting assistance from the auditor. What type of threat may exist in this situation?
A. A self-review threat may exist because if the external auditor accepts the assignment to complete bookkeeping services, this will put the auditing firm in a position of having to review its own work.
B. A self-interest threat is likely to exist because the auditor will now benefit from increased revenues from the client due to the ancillary work taken on.
C. A management participation threat may exist because in taking on and completing extra services for the client, the auditor is more likely to be involved in managerial decisions and assume a managerial role.

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D. An advocacy threat could exist because the external auditor will now benefit financially from an interest with the client.

Ans: A, LO: 3, Bloom: Analyze, Difficulty: Medium, Min: 1, AACSB: Ethics, AICPA BB: None, AICPA FC: Reporting, AICPA PC: None

Solution: A self-review threat may exist because if the external auditor accepts the assignment to complete bookkeeping services, this will put the auditing firm in a position of having to review its own work.

67. During the audit of Frame Company, a medium size firm that specializes in framing services, the external auditor has determined that one of the client's key officers has a conflict of interest. This conflict of interest has been brought to the attention of the firm's board of directors who have proceeded to reassign the employee accordingly. What type of safeguard does this represent, and why?
A. This type of safeguard represents a safeguard created by the profession, because the code specifically prohibits conflicts of interest within the client's management.
B. This type of safeguard represents a safeguard implemented by the client, because the client's senior management took action to reassign the key employee to a different role, removing the conflict of interest.
C. This represents a safeguard employed by the accounting firm, because the auditor preemptively notified management of the conflict of interest.
D. None of the choices is correct.

Ans: B, LO: 3, Bloom: Analyze, Difficulty: Medium, Min: 1, AACSB: Ethics, AICPA BB: None, AICPA FC: Reporting, AICPA PC: None

Solution: This type of safeguard represents a safeguard implemented by the client, because the client's senior management took action to reassign the key employee to a different role, removing the conflict of interest.

68. A/an _____ threat exists if a CPA performs bookkeeping services for a private company client and that work needs to be evaluated by the same firm in the course of an attest engagement.
A. self-review
B. undue influence
C. adverse interest
D. advocacy

Ans: A, LO: 3, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Decision Making

Solution: A self-review threat exists if a CPA performs bookkeeping services for a private company client and that work needs to be evaluated by the same firm in the course of an attest engagement.

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69. If a CPA is unable to implement effective safeguards, what should the CPA do?
A. Decline the engagement.
B. Proceed with the professional service.
C. Document the identified threats.
D. Evaluate the significance of the threat.

Ans: A, LO: 3, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Decision Making

Solution: If a CPA is unable to implement effective safeguards, the CPA should decline or terminate the engagement.

70. Rules of Professional Conduct and related interpretations are specifically written for _____.
A. FASB members
B. Accountants in public practice
C. Accountants in private practice
D. SEC personnel

Ans: B, LO: 3, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

Solution: The rules of professional conduct and related interpretations are specifically written for those in public practice.

71. In the absence of a rule or an interpretation, a CPA could use which of the following to apply to the accounting for a certain situation?
A. The SEC rulings
B. The Conceptual Framework
C. An auditing textbook
D. The IRS Code

Ans: B, LO: 3, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

Solution: The rules in the AICPA Code of Professional Conduct and related interpretations seek to address many situations for members in public practice. However, the rules and interpretations cannot address every possible relationship or circumstance that might arise. Thus, in the absence of a rule or an interpretation, a CPA should use the Conceptual Framework to evaluate what to do.

72. A threat that is due to a long or close relationship is a(n) _____.
A. familiarity threat
B. management participation threat
C. self-interest threat
D. self-review threat

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Ans: A, LO: 3, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

Solution: A familiarity threat is due to a long or close relationship.

73. A threat that a CPA will take on the role of client decision making or assume associated responsibilities is a(n) _____.
A. familiarity threat
B. management participation threat
C. self-interest threat
D. self-review threat

Ans: B, LO: 3, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

Solution: A management participation threat is the threat that a CPA will take on the role of client decisions or assume associated responsibilities.

74. A threat that a CPA will promote a client's interests or position to the point that his or her objectivity is compromised is a(n) _____.
A. familiarity threat
B. advocacy threat
C. self-interest threat
D. self-review threat

Ans: B, LO: 3, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

Solution: The advocacy threat is the threat that a CPA will promote a client's interests to the point that his or her objectivity is compromised.

75. A threat that a CPA will not act with objectivity because the CPA's interests are opposed to the client's interests is a(n) _____.
A. familiarity threat
B. advocacy threat
C. self-interest threat
D. adverse Interest Threat

Ans: D, LO: 3, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

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

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

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

Ans: C, LO: 3, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

Solution: The self-interest threat is the threat that a CPA could benefit from an interest in or relationship with a client or persons associated with the client.

77. A threat that a CPA will not appropriately evaluate the results of a previous judgment made by, or service performed by, an individual in the CPA's firm is a(n) _____.
A. familiarity threat
B. advocacy threat
C. self-interest threat
D. self-review threat

Ans: D, LO: 3, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

Solution: The self-review threat is the threat that a CPA will not appropriately evaluate the results of a previous judgment made by, or service performed by, and individual in the CPA's firm.

78. A threat that a CPA will allow a third party to coerce his/her judgment about a client is known as a(n):
A. familiarity threat
B. advocacy threat
C. self-interest threat
D. undue influence threat

Ans: D, LO: 3, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

Solution: The undue influence threat is the threat that a CPA will allow a third party to coerce his/her judgment about a client.

79. The first step in the process to assist the CPA in making an ethical judgment is _____.
A. identify threats to compliance with rules
B. evaluate the significance of the threat
C. identify and apply safeguards
D. evaluate the effectiveness of the safeguards

Ans: A, LO: 3, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

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Solution: The first step is to identify threats.

80. The last step in the process to assist the CPA in making an ethical judgment is _____.
A. document the threats and safeguards
B. evaluate the significance of the threat
C. identify and apply safeguards
D. evaluate the effectiveness of the safeguards

Ans: A, LO: 3, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

Solution: The last step is to document the threats and safeguards.

81. The second step in the process to assist the CPA in making an ethical judgment is _____.
A. identify threats to compliance with rules
B. evaluate the significance of the threat
C. identify and apply safeguards
D. evaluate the effectiveness of the safeguards

Ans: B, LO: 3, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

Solution: The second step is to evaluate the significance of the threat.

82. The third step in the process to assist the CPA in making an ethical judgment is _____.
A. identify threats to compliance with rules
B. evaluate the significance of the threat
C. identify and apply safeguards
D. evaluate the effectiveness of the safeguards

Ans: C, LO: 3, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

Solution: The third step is to identify and apply safeguards.

83. The fourth step in the process to assist the CPA in making an ethical judgment is _____.
A. identify threats to compliance with rules
B. evaluate the significance of the threat
C. identify and apply safeguards
D. evaluate the effectiveness of the safeguards

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Ans: D, LO: 3, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

Solution: The fourth step is to evaluate the effectiveness of the safeguards

84. A CPA should judge his or her ethical conduct from the perspective of a _____.
A. reasonable and informed third party
B. circuit court judge
C. high school graduate
D. IRS agent

Ans: A, LO: 3, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

Solution: A CPA should judge his or her ethical conduct from the perspective of a reasonable and informed third party.

85. What are the three types of safeguards against threats to a CPA's compliance with the ethical rules of the profession?
A. Independence, legal liability, and accounting standards
B. Self-control, internal compass, and future goals
C. Safeguard of regulation, client implemented controls, and CPA firm policies
D. Safeguard of standards, Acts of Congress, certification

Ans: C, LO: 3, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

Solution: The three types of safeguards are regulation, client implemented controls, and CPA firm policies.

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

Ans: C, LO: 3, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

Solution: If a CPA concludes that threats are at an acceptable level after applying the identified safeguards, then the CPA may proceed with the professional service.

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87. If the CPA is unable to implement effective safeguard to a threat of compliance with the accounting profession's ethical rules, he/she should _____.
A. proceed with the professional service
B. decline or terminate the engagement
C. limit the engagement to all non-audit areas
D. limit the engagement to only Federal taxation

Ans: B, LO: 3, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

Solution: If a CPA is unable to implement effective safeguards, he/she should decline or terminate the engagement.

88. At step 5, when a CPA confronts threats to ethical decision-making and the safeguards applied to reduce the threat, what is the suggested best practice?
A. Document the identified threats, document the safeguards applied, and document the CPA's evaluation of the effectiveness of the safeguards.
B. Immediately decline the engagement, terminate the contract, and contact the AICPA.
C. Contact the FBI, tape all conversations with the client, then offer the engagement to a competitor.
D. Increase the fee charged to absorb any risk, immediately conclude that the threats are at an acceptable level and proceed with an internal control audit.

Ans: A, LO: 3, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

Solution: The CPA should document the identified threats, document the safeguards applied, and document the CPA's evaluation of the effectiveness of the safeguards.

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

Ans: B, LO: 3, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

Solution: This is an example of an advocacy threat.

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90. According to the integrity and objectivity rule, in the performance of any professional service, a member shall not knowingly _____.
A. misrepresent facts
B. decentralize work to subordinates
C. omit a material fact
D. None of the choices is correct.

Ans: A, LO: 4, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Decision Making

Solution: According to the integrity and objectivity rule, in the performance of any professional service, a member shall not knowingly misrepresent facts or subordinate judgment.

91. How does a small firm resolve the conflict of interest issue in a divorce case?
A. Provide tax services to only one of the two parties.
B. Using separate engagement teams in providing tax services to both parties.
C. Resign from the engagement.
D. They do not need to resolve the conflict of interest in the case of a divorce.

Ans: A, LO: 4, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Decision Making

Solution: A small firm remains free of conflict of interest in a divorce case by providing tax services to one of the two parties.

92. Which of the following issues arises when taxes are not properly distributed to the parties involved in a divorce case?
A. Conflict of interest
B. Misrepresentation of fact
C. Legal liability
D. Gross negligence

Ans: A, LO: 4, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

Solution: A conflict of interest arises when tax is not properly distributed to the parties involved in a divorce case.

93. The Integrity and Objectivity Rule, AICPA Codification section 1.100.001 advises that in the performance of any professional service, a member shall maintain objectivity and integrity, shall be free of conflicts of interest, and shall not knowingly misrepresent facts or subordinate his or her judgment to others. Which of the following statements best describes which services performed by a CPA this rule would apply to?
A. All taxation and bookkeeping services performed by the CPA would be covered under this rule.

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B. All bookkeeping and consulting services performed by the CPA would be covered under this rule.
C. This rule covers consulting services offered by the CPA.
D. All of the choices are correct.

Ans: D, LO: 4, Bloom: Analyze, Difficulty: Medium, Min: 1, AACSB: Ethics, AICPA BB: None, AICPA FC: Reporting, AICPA PC: None

Solution: All of these answer choices are correct.

94. Candlestick CPA firm is currently representing a husband and wife in a divorce settlement case. Candlestick is a relatively large CPA firm. Top management of Candlestick are meeting to discuss whether or not a conflict of interest may exist in this case because they are representing both parties in the divorce settlement. Which of the statements below is true regarding Candlestick's best option in this case?
A. Under the AICPA Rules of Professional Conduct, Candlestick is prohibited from representing both parties, as this represents a conflict of interest for the firm.
B. To avoid liability in this case, Candlestick is required under the AICPA Code of Professional Conduct to apprise each party in writing of the representation of the other party.
C. Candlestick must determine if its size will objectively allow two separate engagement teams to represent each client in the divorce case.
D. Candlestick is required to immediately refer one of the two parties in the divorce case to another CPA firm.

Ans: C, LO: 4, Bloom: Analyze, Difficulty: Medium, Min: 1, AACSB: Ethics, AICPA BB: None, AICPA FC: Reporting, AICPA PC: None

Solution: Candlestick must determine if its size will objectively allow two separate engagement teams to represent each client in the divorce case.

95. Sunnyside External Auditors is currently completing the audit of CVL Enterprises; a firm that sells a variety of plastic products around the continental US. During the most recent meeting with the client's senior management, a difference of opinion was noted with respect to an understatement of depreciation expense listed on the income statement which the auditor feels overstates the client's net income. Which of the choices below represent the auditor's best approach to dealing with this difference of opinion?
A. If the overstatement of net income is material in amount but is confined to the income statement, the auditor should conclude the threat is at an acceptable level.
B. If the overstatement of net income is immaterial in amount, the auditor may proceed and document the threat at an acceptable level.

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C. If the understatement of depreciation expense results in a material change to net income, the auditor should notify the SEC and withdraw from the engagement.
D. If the overstatement of net income is not corrected immediately, the auditor should notify management in writing of their intention to withdraw from the engagement.

Ans: B, LO: 4, Bloom: Evaluate, Difficulty: Hard, Min: 1, AACSB: Ethics, AICPA BB: None, AICPA FC: Reporting, AICPA PC: None

Solution: If the overstatement of net income is immaterial in amount, the auditor may proceed and document the threat at an acceptable level.

96. What should a CPA do if he/she concludes a difference of opinion with an audit supervisor regarding an on-going audit engagement may result in a material misrepresentation of fact or a violation of professional standards?
A. Quit the job.
B. Discuss his or her concerns with the supervisor.
C. Obtain more training.
D. Search for a certification that focuses on material misrepresentations.

Ans: B, LO: 4, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

Solution: The CPA should discuss his or her concerns with the supervisor.

97. The rule on integrity and objectivity applies to _____.
A. all services performed by CPAs
B. some services performed by CPAs
C. only audit, services performed by CPAs
D. only non-audit services performed by CPAs

Ans: A, LO: 4, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

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

98. What are the two common issues that arise and are related to integrity and objectivity?
A. Conflicts of interest and subordination of judgment.
B. Ethical judgment and subjectivity.
C. Independence and compliance
D. Efficiency and effectiveness.

Ans: A LO: 4, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

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Solution: Conflicts of interest and subordination of judgment are the two common issues that arise related to integrity and objectivity.

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

Ans: A, LO: 4, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

Solution: The subordination of judgment threat is at an acceptable level when the CPA concludes the position taken by the firm does not result in a material misrepresentation of fact or a violation of applicable standards, laws, or regulations.

100. When might self-interest, familiarity, and undue influence most likely threaten a CPA's compliance with integrity and objectivity?
A. When a CPA and his or her supervisor, or another person within the CPA firm, have a difference of opinion related to the application of accounting principles
B. When a CPA mistakenly applies the wrong auditing standard
C. When a CPA pads his or her expense account
D. When a CPA takes concerns about an engagement to another partner

Ans: A, LO: 4, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

Solution: When a CPA and his or her supervisor, or another person within the CPA firm, have a difference of opinion related to the application of accounting principles. self-interest, familiarity, and undue influence most likely threaten a CPAs compliance with integrity and objectivity.

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

Ans: B, LO: 4, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

Solution: Conflict of interest occurs when a CPA performs a professional service related to a particular matter involving two or more clients whose interests, with respect to that matter, are in conflict.

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102. What safeguards do most CPA firms have against conflicts of interest and subordination of judgment?
   A. Specific policies to prevent the firm from violating professional standards and to protect the CPA.
   B. Monetary settlements for severance pay to the CPA involved.
   C. Whistleblower rules and regulations.
   D. Human resource counseling and tip hotlines.

   Ans: B, LO: 4, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

   Solution: Most firms have specific policies to prevent the firm from violating professional standards and to protect the CPA

103. If after discussing a potential subordination of judgment threat with a supervisor, a CPA does not feel that the matter is resolved, what should he or she do?
   A. Discuss his or her concerns with the appropriate higher level(s) of management within the CPA's firm.
   B. Contact the AICPA about the problem.
   C. Immediately ask HR to reassign him or her.
   D. Start looking for a new position at another firm.

   Ans: A, LO: 4, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

   Solution: The CPA should discuss his or her concerns with the appropriate higher level(s) of management within the CPA's firm.

104. In a small CPA firm, if the firm provides tax services to both parties who subsequently begin divorce proceedings, it is customary to do what?
   A. Resign providing tax services to one of the two parties in a divorce to remain free of any conflict of interest.
   B. Use separate engagement teams in providing tax services to the husband and to the wife, who are provided clear policies and procedures on maintaining confidentiality.
   C. Engage in a background check on both parties.
   D. Provide only consulting services to both parties.

   Ans: A, LO: 4, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

   Solution: The firm should resign from providing tax services to one of the two parties in a divorce to remain free of any conflict of interest.

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105. A committee of the board of directors responsible for oversight of internal controls, financial reporting and disclosure in the financial statements, regulatory compliance, and the company's independent auditors is/are called (a/an) _____.
A. audit committee
B. covered members
C. executors
D. dependents

Ans: A, LO: 5, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Decision Making

Solution: A committee of the board of directors responsible for oversight of internal controls, financial reporting and disclosure in the financial statements, regulatory compliance, and the company's independent auditors is called an audit committee.

106. Interpretation 1.295 indicates that before performing nonattest services, the CPA should establish and document in writing an understanding with the client regarding _____.
A. any limitations of the engagement, only
B. the objectives of the engagement and the services to be performed, only
C. the services to be performed, only
D. the objectives of the engagement, the services to be performed, and any limitations of the engagement

Ans: D, LO: 5, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Decision Making

Solution: Interpretation 1.295 indicates that before performing nonattest services, the CPA should establish and document in writing an understanding with the client regarding the objectives of the engagement, the services to be performed, and any limitations of the engagement.

107. As a general rule, professional employees in a CPA firm who are not covered members and their immediate family members cannot _____.
A. be a trustee, director, or officer of an attest client or of the client's pension or profit-sharing trust
B. have a direct investment of more than 1% in an attest client
C. hold a non-key position with an attest client
D. have an indirect investment of more than 5% in an attest client

Ans: A, LO: 5, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Decision Making

Solution: As a general rule, professional employees in a CPA firm who are not covered members and their immediate family members cannot have a direct investment of more than 5% in an attest client, hold a key position with an attest client, and be a trustee, director, or officer of an attest client or of the client's pension or profit-sharing trust.

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108. A _____ is someone who prepares or supervises others involved in preparing the financial statements or material accounting records or someone who is involved in accounting decision making.
A. key person
B. covered member
C. trustee
D. immediate family member

Ans: A, LO: 5, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Decision Making

Solution: A key person is someone who prepares or supervises others involved in preparing the financial statements or material accounting records or someone who is involved in accounting decision making.

109. AICPA Codification section 1.200.001 addresses auditor independence and advises that a member in public practice shall be independent in the performance of professional services as required by standards promulgated by bodies designated by Council. Which of the choices below best collectively represent the reasons the auditor must maintain independence?
A. Auditor independence helps maintain the CPAs professional and independent image, and indemnifies the auditor against external litigation.
B. Auditor independence is measured by independence in appearance which dictates that the auditor act with integrity and objectivity at all times throughout an engagement.
C. Auditor independence in fact and appearance helps solidify the CPAs professional reputation in the eyes of the public, and also aligns with a CPAs duty to uphold the public interest.
D. If an auditor is perceived as not being independent in fact and appearance, the likelihood of litigation against the client and auditor will generally decrease.

Ans: C, LO: 5, Bloom: Analyze, Difficulty: Medium, Min: 1, AACSB: Ethics, AICPA BB: None, AICPA FC: Reporting, AICPA PC: None

Solution: Auditor independence in fact and appearance helps solidify the CPAs professional reputation in the eyes of the public, and also aligns with a CPAs duty to uphold the public interest.

110. While conducting the external audit of GreenLeaf Enterprises, the audit manager of Jackson external auditors responsible for the day-to-day operations and staff assigned to the audit has been meeting with the CFO of GreenLeaf Enterprises each Friday for a working lunch at a local restaurant. The meeting is designed to provide an informal atmosphere whereby the audit manager can keep the CFO abreast of the audit and any important matters needing the CFOs attention. A potential issue with independence exists here because

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A. it may be perceived that the audit manager and CFO meeting weekly for lunch compromises independence in fact.
B. it may be perceived that the audit manager and CFO meeting in this manner compromises independence in appearance.
C. it may be assumed by both the client and audit staff that the audit manager is using the lunch to discuss important accounting issues offline.
D. it may be perceived that the weekly meetings have been arranged by the CFO to ensure that there are no surprises with respect to the rendering of the audit opinion upon conclusion of the audit.

Ans: B, LO: 5, Bloom: Analyze, Difficulty: Medium, Min: 1, AACSB: Ethics, AICPA BB: None, AICPA FC: Reporting, AICPA PC: None

Solution: it may be perceived that the audit manager and CFO meeting in this manner compromises independence in appearance.

111. During the audit of Brown Company, the lead partner assigned to the audit engagement has learned from the client's board of directors that the company will soon begin paying a healthy dividend on outstanding stock. Brown Company plans to issue a press release in the following month to apprise the market of this. The lead partner assigned to this audit contacts a close friend and advises him of this, instructing him to buy up some of the company stock as he believes the value will increase. With respect to independence, this action would best be described as
A. no threat to independence in appearance, because the partner is using a close friend to buy the stock and thus appear beyond reproach.
B. no threat to independence in fact, because the lead partner has avoided a conflict of interest by having a friend purchase the stock.
C. a threat to independence in fact, because the audit partner assigned to the engagement is neglecting the public trust for personal gain.
D. a threat to independence in appearance because if it is determined that the audit partner took this action, his or her reputation would be damaged.

Ans: C, LO: 5, Bloom: Analyze, Difficulty: Medium, Min: 1, AACSB: Ethics, AICPA BB: None, AICPA FC: Reporting, AICPA PC: None

Solution: a threat to independence in fact, because the audit partner assigned to the engagement is neglecting the public trust for personal gain.

112. With the advent of accounting and CPA firms that have many professionals spread out diffusely all over the globe, many issues arise with respect to independence. An example of an issue that may arise is related to
A. an increase in the demand for non-auditing services, which may allow CPA firms extra sources of revenue.
B. whether family members of a CPA or covered member may inadvertently cause threats to independence.

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C. whether any covered members may have a direct or indirect investment in the client under audit.
D. All of the choices are correct.

Ans: D, LO: 5, Bloom: Analyze, Difficulty: Medium, Min: 1, AACSB: Ethics, AICPA BB: None, AICPA FC: Reporting, AICPA PC: None

Solution: All of these answer choices are correct.

113. During the course of the external audit, Moon Auditing Firm has discovered that one of their senior audit managers has a mortgage outstanding from the audit client, TMI Bank. Moon Auditing Firm has policies and protocols in place surrounding conflicts of interest in this area. Which of the choices below would represent Moon's best course of action given these circumstances?
A. If the senior audit manager is a covered member, he or she should immediately be reassigned to a different audit client.
B. Moon should obtain permission to investigate the details of the outstanding mortgage, to determine when the mortgage loan was taken out, and should ask the employee to refinance immediately.
C. An exception exists for covered members holding mortgage balances with attest clients.
D. This represents confidential information and is beyond the scope and purview of audit confidentiality.

Ans: C, LO: 5, Bloom: Evaluate, Difficulty: Hard, Min: 1, AACSB: Ethics, AICPA BB: None, AICPA FC: Reporting, AICPA PC: None

Solution: An exception exists for covered members holding mortgage balances with attest clients.

114. During the external audit of Sun Enterprises, Inc. a senior audit staff associate approaches you, as the audit manager with responsibility for day-to-day operations of the engagement and advises that she has been approached by the audit client with respect to filling a current vacancy for head of the Internal Audit Department. In response to this, and following a conversation with the partner with overall responsibility for the audit, the decision is made to remove the audit senior from the audit and reassign her to a different client. Which of the following best describes the reasoning that underpins this decision?
A. This employment offer represents a threat to the audit in the sense that the audit associate may now be more lenient to the client and overlook areas of audit concern.
B. The auditors' objectivity and independence are immediately considered impaired, and thus the associate should be immediately removed from the engagement.
C. To avoid situations where a CPAs integrity or objectivity may be compromised, which would impair the auditors credibility and independence.

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D. When an audit firm employee is offered unemployment with a potential client, the audit firm may be able to take advantage of access to information that they otherwise would not have had.

Ans: C, LO: 5, Bloom: Analyze, Difficulty: Medium, Min: 1, AACSB: Ethics, AICPA BB: None, AICPA FC: Reporting, AICPA PC: None

Solution: To avoid situations where a CPAs integrity or objectivity may be in a position of being compromised, which would impair the auditors credibility and independence.

115. During the external audit of Starbright Company, the external auditor has noted that the company has an extremely high turnover of employees. During a recent meeting, Starbright management has advised that the treasurer has recently left to take another position with a different company, and has asked the senior audit manager assigned to the audit to sign checks in an emergency capacity until a suitable replacement has been found. Which of the choices below best describe the problem with this situation?
   A. The audit manager may take advantage of this situation to write other checks for personal gain, and there may be no internal controls to detect this.
   B. The CPA authorizing disbursements of client funds, even in an emergency capacity may represent a threat to independence as the auditor is exercising authority on behalf of a client.
   C. The audit manager has been placed in a situation whereby a conflict of interest exists, and should withdraw from the engagement immediately.
   D. By writing checks on behalf of the client, the external auditor assumes responsibility for any bounced checks.

Ans: B, LO: 5, Bloom: Analyze, Difficulty: Medium, Min: 1, AACSB: Ethics, AICPA BB: None, AICPA FC: Reporting, AICPA PC: None

Solution: The CPA authorizing disbursements of client funds, even in an emergency capacity may represent a threat to independence as the auditor is exercising authority on behalf of a client.

116. During a recent meeting with the top management of Axle Co. advice has been requested on certain stock transactions that the client has entered into. The client is seeking the CPA firm's advice and input on whether to sell certain stocks that management feel may drop in value in the near future, and indicates they may ask the CPA firm to conduct the transactions. Does this represent a threat to independence, and why?
   A. This does not represent a threat to independence, as the client is merely asking for the CPA firm's unofficial input.
   B. This does not represent a threat to independence, as even if advice is given, the client is still wholly responsible for any gains or losses incurred.
   C. This may represent a threat to independence, as if the CPA firm gives bad advice, the client may sue the CPA firm.

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D. This may represent a threat to independence, as the CPA firm may ultimately end up making investment decisions on behalf of the client.

Ans: D, LO: 5, Bloom: Analyze, Difficulty: Medium, Min: 1, AACSB: Ethics, AICPA BB: None, AICPA FC: Reporting, AICPA PC: None

Solution: This may represent a threat to independence, as the CPA firm may ultimately end up making investment decisions on behalf of the client.

117. SEC rules prohibit an audit firm from providing which of the following non-attest services to an audit client?
A. Actuarial services, only
B. Internal audit outsourcing and bookkeeping services, only
C. Bookkeeping and actuarial services, only
D. Internal audit outsourcing, bookkeeping, and actuarial services

Ans: D, LO: 5, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Decision Making

Solution: SEC rules prohibit an audit firm from providing the following non-attest services to an audit client: 1) Internal audit outsourcing services; 2) Bookkeeping services; and 3) Actuarial services.

118. Attest services do not include _____.
A. audits
B. reviews under SSARs
C. examinations, reviews and agreed-upon procedures under SSAE
D. compilation reports of financial statements

Ans: D, LO: 5, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

Solution: Attest services do not include compilations.

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

Ans: B, LO: 5, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

Solution: Independence in fact is best defined as acting with integrity and objectivity.

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120. Being independent in appearance is best defined as _____.
   A. addressing potential conflicts of interest that can be observed or factually determined by others
   B. acting with integrity and objectivity
   C. acting with independence and integrity
   D. disclosing some of the common threats that he or she faces to acting independently

Ans: A, LO: 5, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

Solution: Independence in appearance is best defined as addressing potential conflicts of interest that can be observed or factually determined by others.

121. Section 1.200 of the AICPA Code of Professional Conduct specifies a number of circumstances that can impair _____.
   A. the appearance of independence to guide CPAs in observable aspects of ethical conduct
   B. the appearance of integrity regarding ethical conduct
   C. safeguards that prevent a lack of independence
   D. how to evaluate threats as an independent third-party

Ans: A LO: 5, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

Solution: Section 1.200 specifies a number of circumstances that can impair the appearance of independence.

122. A covered member, under the independence rules in the AICPA Code of Professional Conduct, is best defined as a person in a position to _____.
   A. potentially influence attest decisions or the outcome of an attest engagement
   B. potentially influence decisions or outcomes in non-audit services
   C. take on or influence a third-party position
   D. perform tax services that is both independent in fact and appearance

Ans: A, LO: 5, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

Solution: A covered member is a person in a position to potentially influence attest decisions or the outcome of an attest engagement.

123. Which of the following statements is true?
   A. A covered member can own one share of an attest client because it is immaterial.

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

Ans: D, LO: 5, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

Solution: A CPA firm as an entity is prohibited from the same activities as a covered member of the firm.

124. Which of the following activities is not a prohibited activity that impairs independence?
A. A direct investment in the attest client
B. A joint, closely held investment with an attest client that is material to the covered member
C. A material indirect investment in the attest client
D. Having a home mortgage from a bank who is an attest client

Ans: D, LO: 5, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

Solution: Having a home mortgage from a bank who is an attest client is allowed.

125. When can a spouse that works for an attestation client still participate in an employee benefit plan that includes employee stock ownership plans or employee stock option plans?
A. There are no restrictions.
B. when the benefits are offered equitably to all similar employees
C. When the benefits are offered equitably to a majority of similar employees
D. As long as the CPA firm approves every stock-related plan

Ans: B, LO: 5, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

Solution: A spouse can work for the attest client and still participate in an employee benefit plan that includes employee stock ownership plans or employee stock option plans as long as benefits are offered equitably to all similar employees.

126. Which of the following standards refers to undertaking professional services that can be completed with the appropriate level of professional skill?
A. Professional Competence
B. Due Professional Care

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C. Sufficient Relevant Data
D. Planning and Supervision

Ans: A, LO: 6, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

Solution: Professional Competence refers to undertaking professional services that can be completed with professional competence. (skill)

127. According to the due professional care standard, CPAs should exercise professional care expected of _____ in the performance of professional services.
A. other CPAs
B. covered members
C. CPAs involved in consulting services
D. a reasonable person

Ans: A, LO: 6, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

Solution: According to the due professional care standard, CPAs should exercise professional care expected of other CPAs in the performance of professional services.

128. During an initial client meeting with Broadside Enterprises, the external auditors, RayBright CPAs are discussing the client's needs. Broadside management has expressed a desire for RayBright to perform auditing and attestation services, as well as some ancillary accounting services. As RayBright seeks to determine which services it can effectively perform, which General Standard would be most applicable to this decision?
A. The Sufficient Relevant Data standard, as RayBright will need to make sure it has access to all required data in order to make the decision.
B. The Professional Competence standard, as RayBright should only undertake services it can perform with professional competence.
C. The Planning and Supervision standard, as RayBright needs to understand the scope of services it can perform in order to assign the appropriate audit staff.
D. The Due Professional Care standard, as the level of professional care will depend on the level of services performed.

Ans: B, LO: 6, Bloom: Analyze, Difficulty: Medium, Min: 1, AACSB: Ethics, AICPA BB: None, AICPA FC: Reporting, AICPA PC: None

Solution: The Professional Competence standard, as RayBright should only undertake services it can perform with professional competence.

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129. During an initial client meeting with Broadside Enterprises, the external auditors, RayBright CPAs are discussing the client's needs. Broadside management has agreed to hire the auditor and provided RayBright with details of what work needs to be done. Broadside operates in a niche industry which requires specialized knowledge. As RayBright seeks to determine the most effective way to perform the audit of Broadside, which General Standard would be most applicable to this decision?
   A. The Planning and Supervision standard, as RayBright will want to ensure staff with the appropriate expertise are assigned to this audit.
   B. The Sufficient Relevant Data standard, as RayBright will need to make sure it has access to all required data in order to make the decision.
   C. The Due Professional Care standard, as the level of professional care will depend on the level of services performed.
   D. The Professional Competence standard, as RayBright should only undertake services it can perform with professional competence.

   Ans: A, LO: 6, Bloom: Analyze, Difficulty: Medium, Min: 1, AACSB: Ethics, AICPA BB: None, AICPA FC: Reporting, AICPA PC: None

   Solution: The Planning and Supervision standard, as RayBright will want to ensure staff with the appropriate expertise are assigned to this audit.

130. Which of the following general standards refers to adequately preparing for the engagement and providing the appropriate management oversight to the performance of professional services?
   A. Planning and Supervision
   B. Sufficient Relevant Data
   C. Due Care
   D. Audit Planning

   Ans: A, LO: 6, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

   Solution: Planning and Supervision is the general standard that expects CPAs to adequately plan and supervise the performance of professional services.

131. The general standards in the AICPA Code of Professional Conduct do NOT include _____.
   A. professional competence
   B. due professional care
   C. planning for materiality
   D. sufficient relevant data

   Ans: C, LO: 6, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

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Solution: The general standards to not include planning for materiality.

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

Ans: A, LO: 6, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

Solution: Professional competence is: undertake only those professional services that the member or the member's firm can reasonably expect to be completed with professional competence.

133. Which of the following standards is used for preparing financial statements with other accounting principles?
A. GAAP
B. GAAS
C. Rule 1.320 on Accounting Principles
D. Principles of the Code of Professional Conduct

Ans: A, LO: 7, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

Solution: Generally Accepted Accounting Principles (GAAP) is used for preparing financial statements with other accounting principles.

134. CPAs in public practice are required to adhere to strict rules pertaining to client confidentiality. In general, client permission must be obtained before the CPA releases any confidential information. Which of the scenarios below best represents a viable exception to the client confidentiality rules?
A. An audit client of the CPA contacts the auditor to object about information that will be disclosed in the financial statements which the client feels is confidential.
B. The CPA discloses confidential client information as a result of a subpoena received from a legal authority.
C. The CPA discloses all confidential client information as part of a peer review instituted by a State Board of Accountancy.
D. There are no exceptions to the client confidentiality rule.

Ans: B, LO: 7, Bloom: Analyze, Difficulty: Medium, Min: 1, AACSB: Ethics, AICPA BB: None, AICPA FC: Reporting, AICPA PC: None

Solution: The CPA discloses confidential client information as a result of a subpoena received from a legal authority.

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135. Which of the following should auditors know in regard to potential lawsuits against them?
A. People who can sue them
B. Allegations made in lawsuits
C. Defenses they can use in court
D. All the options are correct.

Ans: D, LO: 7, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Communication, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

Solution: Auditors should know people who can sue them, the allegations made in lawsuits, and defenses they can use in court.

136. The rule on fees and other types of remuneration address how many circumstances that are extremely important?
A. 1
B. 2
C. 3
D. 4

Ans: B, LO: 7, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

Solution: The rule of fees and other types of remuneration address two circumstances that are extremely important. These are Rule 1.510 on Contingent Fees and Rule 1.520 on Commissions and Referral Fees.

137. An important issue, and one of major concern to an external auditor and CPA firm is legal liability. The CPA firm may have to contend with litigation and must be prepared to respond accordingly. Which of the following most accurately describes an auditor's potential liability under common law?
A. Under common law, an auditor may be liable to clients under either common law or tort law, but the auditor is not liable to third parties.
B. Under common law, an auditor may be liable to other beneficiaries, which represent a foreseen class of third parties.
C. Common law makes the auditor liable under either contract or tort law, and may also make the auditor liable to foreseen and foreseeable third parties.
D. Under common law doctrines and precedents, the auditor does not assume any liability for audit and attest engagements. The liability is solely the clients.

Ans: C, LO: 8, Bloom: Evaluate, Difficulty: Hard, Min: 1, AACSB: Ethics, AICPA BB: None, AICPA FC: Reporting, AICPA PC: None

Solution: Common law makes the auditor liable under either contract or tort law, and may also make the auditor liable to foreseen and foreseeable third parties.

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138. HappyDaze external auditors is currently being sued under contract law for rendering a clean audit opinion on financial statements which it was later determined contained material misstatements. The lawsuit alleges breach of contract on the part of the external auditor. Which of the following choices would most likely represent a successful argument for the plaintiff in bringing this suit?
   A. HappyDaze, during the course of the audit, did not adhere to Generally Accepted Auditing Standards, and therefore are liable accordingly.
   B. Due to delays by the client in providing information that the auditor had requested in a timely manner, the audit report was delivered later than the initially agreed-upon date.
   C. Although HappyDaze issued an audit report in compliance with Generally Accepted Auditing Standards, the plaintiff believes that the auditor was still negligent.
   D. None of the choices is correct.

   Ans: A, LO: 8, Bloom: Analyze, Difficulty: Medium, Min: 1, AACSB: Ethics, AICPA BB: None, AICPA FC: Reporting, AICPA PC: None

   Solution: HappyDaze, during the course of the audit, did not adhere to Generally Accepted Auditing Standards, and therefore are liable accordingly.

139. During an initial client meeting with Brightspace Paint Company, senior management have advised the new external auditor, Accuracy Auditing Inc. that a current lawsuit is pending against the predecessor auditor. The lawsuit, a fraud case, was brought by Brightspace's bonding company. In this case, the bonding company would represent:
   A. a primary beneficiary, because the bonding company as part of the bonding agreement was required to reimburse the client due to fraud.
   B. a primary beneficiary, because the bonding company represents a foreseen class of third parties.
   C. a subrogee, because the bonding company has acquired the rights of another entity by means of substitution.
   D. None of the choices is correct.

   Ans: C, LO: 8, Bloom: Analyze, Difficulty: Medium, Min: 1, AACSB: Ethics, AICPA BB: None, AICPA FC: Reporting, AICPA PC: None

   Solution: a subrogee, because the bonding company has acquired the rights of another entity by means of substitution.

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140. Teflon Auditors are currently the subject of litigation by a third party who asserts that the auditor was negligent during a recent audit. As a result of the alleged negligence, the third party was injured and is seeking recompense against the auditor. Specifically, the third party is alleging a failure of due care on the part of the auditor. The argument most likely to prevail in court in successfully litigating this case is for
   A. the third party to allege fraud, as a failure of due care may be construed by a court as misrepresentation or nondisclosure of a material fact.
   B. the third party to allege ordinary negligence on the grounds that the auditor failed to exercise the care a reasonable person would have exercised under similar circumstances.
   C. the third party to allege gross negligence, as a lack of due care may be construed by a court to represent a failure to use even slight care in the circumstances.
   D. None of the choices is correct.

Ans: B, LO: 8, Bloom: Analyze, Difficulty: Medium, Min: 1, AACSB: Ethics, AICPA BB: None, AICPA FC: Reporting, AICPA PC: None

Solution: the third party to allege ordinary negligence on the grounds that the auditor failed to exercise the care a reasonable person would have exercised under similar circumstances.

141. Lucky External Auditors are currently in discussions with the management of SunnySide Enterprises with respect to possibly performing an attest engagement for this client. The client has disclosed that the audit report is primarily needed for their bank, which they have recently applied for a substantial loan with to fund future growth and expansion. Based on the information provided in this scenario, which of the following statements most accurately describes the external auditors' potential liability to the client's bank?
   A. The client's bank would represent a primary beneficiary under common law, on the basis that the client disclosed the name of the bank and the reason for the audit.
   B. The client's bank would represent another beneficiary, as under common law, creditors fall into the class of other beneficiaries.
   C. The client's bank would represent a primary beneficiary under common law on the basis that the bank can only bring suit against the auditor if the client chooses to also.
   D. As a third party, the external auditor is not liable to the bank, and the bank is unable to bring suit against the auditor as the result of an audit.

Ans: A, LO: 8, Bloom: Analyze, Difficulty: Medium, Min: 1, AACSB: Ethics, AICPA BB: None, AICPA FC: Reporting, AICPA PC: None

Solution: The client's bank would represent a primary beneficiary under common law, on the basis that the client disclosed the name of the bank and the reason for the audit.

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142. Breezy Inc. is bringing suit against Hazy Firm external auditors on the grounds of negligence on the part of the auditor. Specifically, Breezy asserts that due to the auditor's negligence, Breezy has been injured financially and is seeking restitution. In order to successfully litigate such a case, Breezy will have to be able to do which of the following?
   A. Breezy will have to prove that they owed a duty of care to the auditors, and that this duty of care was breached.
   B. Breezy will have to show that the auditor's negligence was the proximate cause of their damage, and that the auditor breached a duty of care.
   C. Breezy will have to show that they suffered actual damages as a result of the auditor's negligence, and that Breezy did not breach their duty of care.
   D. All of the choices are correct.

   Ans: B, LO: 8, Bloom: Analyze, Difficulty: Medium, Min: 1, AACSB: Ethics, AICPA BB: None, AICPA FC: Reporting, AICPA PC: None

   Solution: Breezy will have to show that the auditor's negligence was the proximate cause of their damage, and that the auditor breached a duty of care.

143. Breezy Inc. is bringing suit against Hazy Firm external auditors on the grounds of negligence on the part of the auditor. Specifically, Breezy asserts that due to the auditor's negligence, Breezy has been injured financially and is seeking restitution. What would the external auditor's best defense to this lawsuit be?
   A. That the auditor was not negligent and owed a duty of care to Breezy Inc.
   B. That because Breezy did not suffer any actual losses as a result of the auditor's actions, no duty of care was owed by the auditor.
   C. That Breezy had no losses as a result of the audit, or that the losses were caused by different events.
   D. All of the choices are correct.

   Ans: C, LO: 8, Bloom: Analyze, Difficulty: Medium, Min: 1, AACSB: Ethics, AICPA BB: None, AICPA FC: Reporting, AICPA PC: None

   Solution: That Breezy had no losses as a result of the audit, or that the losses were caused by different events.

144. Hensley Auditing Firm has been contacted by Wythe Company to discuss an attest engagement centering around an initial public offering of stock the client is contemplating. If the client proceeds with the stock issuance and the client and auditor are subsequently sued by parties who purchased securities as a result of the initial offering, the lawsuit is most likely to be on which grounds?
   A. The suit is likely to be filed under the Securities Act of 1933, alleging a material misleading financial statement.
   B. The suit will be filed under the SEC Act of 1934, alleging reliance on false or misleading financial statements.

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C. The suit will likely be filed under the Securities Act of 1933, with the plaintiff attempting to link the financial loss to the misleading financial statements.
D. The suit will likely be filed under the Sarbanes-Oxley Act, with the plaintiff alleging reliance on the financial statements, and a material loss suffered as a result.

Ans: A, LO: 9, Bloom: Analyze, Difficulty: Medium, Min: 1, AACSB: Ethics, AICPA BB: None, AICPA FC: Reporting, AICPA PC: None

Solution: The suit is likely to be filed under the Securities Act of 1933, alleging a material misleading financial statement.

145. Hensley Auditing Firm has been contacted by Wythe Company to discuss an attest engagement centering around an initial public offering of stock the client is contemplating. If the client proceeds with the stock issuance and the client and auditor are subsequently sued by parties who purchased securities as a result of the initial offering, which of the following would represent the auditor's best defense in court?
A. The auditor owed no duty of care to the plaintiff, due to no privity of contract existing in these circumstances.
B. That the auditor followed published and appropriate auditing standards, and had reason to believe the accuracy of the registration statement.
C. That the auditor relied on disclosures made by the client, and is thus not liable for misrepresentations made by this party.
D. That the losses suffered by the third party were a result of actions and misrepresentations by the client, not the auditor.

Ans: B, LO: 9, Bloom: Analyze, Difficulty: Medium, Min: 1, AACSB: Ethics, AICPA BB: None, AICPA FC: Reporting, AICPA PC: None

Solution: That the auditor followed published and appropriate auditing standards, and had reason to believe the accuracy of the registration statement.

146. Green Company is undergoing the annual audit by Red Firm Inc. who are external auditors. Red Firm Inc. has audited Green Company for the last five years. During a meeting with top management, it is disclosed to the auditor that Green Company and now the auditor is being sued by a mutual fund that invested in a large number of shares of Green Company's common stock. The mutual fund is bringing suit on the grounds that material misstatements in the financial statements existed. For the mutual fund to prevail in such a case, what would have to be proven in court?
A. That the mutual fund purchased the securities and as a result of reliance on the misleading financial statements suffered damages.
B. Even if no damages were incurred by the mutual fund, the fact that it purchased securities that it otherwise may not have done represent grounds for a successful suit.

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C. Under the Sarbanes-Oxley Act, the plaintiff can bring suit on the grounds of fraud and negligence by the auditor.
D. Under the Securities Act of 1934, the mutual fund is unable to sue the auditor directly. Instead, the individual investors would have to bring suit separately.

Ans: A, LO: 9, Bloom: Evaluate, Difficulty: Hard, Min: 1, AACSB: Ethics, AICPA BB: None, AICPA FC: Reporting, AICPA PC: None

Solution: That the mutual fund purchased the securities and as a result of reliance on the misleading financial statements suffered damages.

147. Green Company is undergoing the annual audit from Red Firm Inc. external auditors. Red Firm Inc. has audited Green Company for the last five years. During a meeting with top management, it is disclosed to the auditor that Green Company and now the auditor is being sued by a mutual fund that invested in a large number of shares of Green Company's common stock. The mutual fund is bringing suit on the grounds that material misstatements in the financial statements existed. Which of the following choices represent the auditor's most likely successful defense to this suit?
A. The auditor must be able to demonstrate reliance on information provided and statements made by the client, in order to be dismissed from the lawsuit.
B. The auditor acted in good faith, and was not aware of any misleading or false statements made by the client.
C. Although the auditor had knowledge of the misleading statements, the firm still acted in good faith and is thus not liable under the Securities Act of 1934.
D. All of the choices are correct.

Ans: B, LO: 9, Bloom: Analyze, Difficulty: Medium, Min: 1, AACSB: Ethics, AICPA BB: None, AICPA FC: Reporting, AICPA PC: None

Solution: The auditor acted in good faith, and was not aware of any misleading or false statements made by the client.

148. During the audit of Summer Company, a large publicly-traded firm, Winter external auditors were approached by the audit client with respect to performing additional services on behalf of the client. The additional services requested by Summer Company include performing some routine internal audit functions and actuarial calculations to assist in pension provision estimates. Which of the following statements is correct regarding Winter's response to this request?
A. The external auditors are able to perform these extra services, but in so doing will increase the overall cost of the audit.
B. Under the Securities Act of 1933, the external auditors are prohibited from performing actuarial services, but can assist with the internal audit work.
C. Under the Sarbanes-Oxley Act, the auditor is prohibited from performing either function as part of an attest engagement.

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D. Under the Sarbanes-Oxley Act, the auditor is free to perform actuarial services for the client, but internal audit outsourcing is prohibited due to an inherent conflict of interest.

Ans: C, LO: 9, Bloom: Analyze, Difficulty: Medium, Min: 1, AACSB: Ethics, AICPA BB: None, AICPA FC: Reporting, AICPA PC: None

Solution: Under the Sarbanes-Oxley Act, the auditor is prohibited from performing either function as part of an attest engagement.

149. Axe Co., a large retailer specializing in fashion merchandise and apparel is receiving its yearly audit from StarShine external auditors. StarShine has been auditing Axe Co. for a number of years and is very familiar with the client. StarShine has been assisting Axe Co. with a recent secondary stock offering and providing technical advice to the client. Under this scenario, StarShine could be liable under which of the following?
   A. Under the Securities Act of 1933, StarShine may be liable for gross negligence if they fail to provide absolute assurance on financial statements issued around the time of the secondary offering.
   B. Under the Sarbanes-Oxley Act, StarShine may be liable for providing a prohibited investment advisory service during an attest function.
   C. Under the Securities Act of 1934, StarShine are not liable for any investment advice given, only for direct lawsuits pertaining to the attest function.
   D. None of the choices is correct.

Ans: B, LO: 9, Bloom: Analyze, Difficulty: Medium, Min: 1, AACSB: Ethics, AICPA BB: None, AICPA FC: Reporting, AICPA PC: None

Solution: Under the Sarbanes-Oxley Act, StarShine may be liable for providing a prohibited investment advisory service during an attest function.

150. During a recent discussion with the top management of GreenTree Company, a large publicly-traded entity, the external auditors, Wood's CPA firm has been apprised that the management of GreenTree may have knowingly allowed misstatements in the firm's most recent financial statements to be published. GreenTree's management are inquiring of the auditor as to management's potential liability in such a situation. The best response to this question by the external auditor would be which of the following?
   A. Once the financial statements have been audited and are published to the public at large, the liability rests solely with the auditor.
   B. It is unlikely that any party bringing such a suit would prevail in court, as all auditor discussions with management are confidential and are not disclosable as evidence in court.
   C. Under the Sarbanes-Oxley Act, management are liable for any misstatements they knowingly allowed to be published and promulgated to the public.

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D. Under the Proportionate Liability doctrine, top management will be personally liable for any damages awarded by a court on a proportionate basis.

Ans: C, LO: 9, Bloom: Analyze, Difficulty: Medium, Min: 1, AACSB: Ethics, AICPA BB: None, AICPA FC: Reporting, AICPA PC: None

Solution: Under the Sarbanes-Oxley Act, management are liable for any misstatements they knowingly allowed to be published and promulgated to the public.

151. What is the other name of the Securities Act of 1933?
A. The Truth in Securities Act
B. The Antifraud Provisions Act
C. The Foreign Corrupt Practices Act
D. The Private Securities Litigation Reform Act

Ans: A, LO: 9, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

Solution: The Securities Act of 1933 is known as the Truth in Securities Act and was enacted following the stock market crash and Great Depression of 1929 on May 27, 1933.

152. _____ subjects auditors to penalties of fines or imprisonment or both.
A. Criminal liability
B. Proportionate liability
C. Diligence defense
D. Bookkeeping

Ans: A, LO: 9, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

Solution: Criminal liability subjects auditors to penalties of fines or imprisonment or both.

153. Under Section 18(a) of the Securities Act of 1934, the plaintiff _____.
A. may be any person buying or selling the securities
B. does not have to prove the existence of a materially false or misleading statement
C. does not have to prove reliance on such a statement and damage resulting from such reliance
D. had no knowledge of the false or misleading statement

Ans: A, LO: 9, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

Solution: Under Section 18(a) of the Securities Act of 1934, the plaintiff may be any person buying or selling the securities and must prove the existence of a materially false or misleading statement and reliance on such a statement and damage resulting from such reliance. Only the defendant has to prove that he/she had no knowledge of the false or misleading statement.

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

   Ans: A, LO: 9, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

   Solution: In a due diligence defense, an audit firm must show that it made a reasonable investigation, that the firm followed auditing standards, and accordingly had a reasonable grounds to believe, and did believe, that the statements certified were true at the date of the statements and as of the time the registration statement became effective.

Question Type: Text Entry

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

   Ans: N/A, LO: 1, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

   Solution: The state government grants a CPA license to those who pass the CPA exam and earn prescribed work experience.

156. A/an _____ is valued by the high level of skill rather than the concern for the public interest.
   A. Expert Competitor | [EC Professional]

   Ans: N/A , LO: 1, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

   Solution: The profession of an EC Professional is defined by the high level of skill, while that of a CPI Professional is recognized by the concern for the public interest.

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157. _____ are accountancy bodies involved in the licensing of CPAs.
A. State Boards of Accountancy
.
Ans: N/A, LO: 1, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

Solution: State Boards of Accountancy are accountancy bodies involved in the licensing of CPAs

158. _____ are often referred to as "pros" because of their skill and level of expertise.
A. Professional athletes

Ans: N/A, LO: 1, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

Solution: Professional athletes are often referred to as "pros" because of their skill and level of expertise.

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

Ans: N/A, LO: 1, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

Solution: Maintain public confidence in the profession.

160. _____ govern the performance of a member's professional responsibilities.
A. Principles

Ans: N/A, LO: 2, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

Solution: Principles govern the performance of a member's professional responsibilities.

161. _____ may be designed in part to encourage ideal behavior, they must also be both practical and enforceable.
A. Codes of ethics

Ans: N/A, LO: 2, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

Solution: Codes of ethics may be designed in part to encourage ideal behavior, they must also be both practical and enforceable.

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

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Ans: N/A, LO: 3, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

Solution: A management participation threat is the threat that a CPA will take on the role of client management or otherwise assume management responsibilities.

163. If a CPA concludes that the threat is not at an acceptable level, the CPA should _____.
A. identify and apply safeguards

Ans: N/A, LO: 3, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

Solution: If a CPA concludes that the threat is not at an acceptable level, the CPA should identify and apply safeguards.

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

Ans: N/A, LO: 3, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

Solution: If a CPA concludes that threats are at an acceptable level after applying the identified safeguards, then the CPA may proceed with the professional service.

165. In a _____ CPA firm, appropriate safeguards might include the involvement of another firm.
A. small

Ans: N/A, LO: 3, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Decision Making

Solution: In a small CPA firm, appropriate safeguards might include the involvement of another firm.

166. The two common issues related to integrity and objectivity are _____and _____.
A. conflicts of interest
B. subordination of judgment

Ans: N/A, LO: 4, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Decision Making

Solution: The two common issues related to integrity and objectivity are conflicts of interest and subordination of judgment.

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

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Ans: N/A, LO: 4, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Decision Making

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

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

Ans: N/A, LO: 4, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Decision Making

Solution: The subordination of judgment threat is at an acceptable level if the CPA concludes that the position taken by the firm does not result in a material misrepresentation of fact.

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

Ans: N/A, LO: 5, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Decision Making

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

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

Ans: N/A, LO: 5, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Decision Making

Solution: A covered member is a person in a position to potentially influence attest decisions or the outcome of an attest engagement.

171. An important issue for many spouses is their ability to participate in _____.
A. stock compensation plans

Ans: N/A, LO: 5, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Decision Making

Solution: An important issue for many spouses is their ability to participate in stock compensation plans.

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

Ans: N/A, LO: 6, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Decision Making

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

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

Ans: N/A, LO: 6, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Communication, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Decision Making

Solution: If a tax practitioner does not have experience performing audits or reviews, he/she should refer the engagement to another qualified CPA.

174. The general standards of the AICPA Code of Professional Conduct apply only to _____ in public practice.
A. CPA firms

Ans: N/A, LO: 6, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Decision Making

Solution: The general standards of the AICPA Code of Professional Conduct apply only to CPA firms that perform professional services for clients.

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

Ans: N/A, LO: 6, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Decision Making

Solution: A CPA should obtain sufficient relevant data to afford a reasonable basis for conclusions or recommendations in relation to any professional services performed.

176. The _____ rule does not preclude a CPA from initiating a complaint with the professional ethics division of the AICPA.
A. confidential client information

Ans: N/A, LO: 7, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Decision Making

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Solution: The confidential client information rule does not preclude a CPA from initiating a complaint with the professional ethics division of the AICPA.

177. An individual or collective group who is not in privity with the parties to a contract is called a _____.
A. third party

Ans: N/A, LO: 8, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Decision Making

Solution: An individual or collective group who is not in privity with the parties to a contract is called a third party.

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

Ans: N/A, LO: 8, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Decision Making

Solution: The auditor's documentation is vital in refuting charges for breach of contract and breach of duty in a tort action.

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

Ans: N/A, LO: 8, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

Solution: Anyone identified to the auditor by name prior to the audit who is a recipient of the auditor's report is called a primary beneficiary.

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

Ans: N/A, LO: 8, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Decision Making

Solution: Other beneficiaries refer to unnamed third parties, such as creditors, stockholders, and potential investors, who use the auditor's report.

181. Auditors have liability under _____ for addressing client requirements.
A. common law

Ans: N/A, LO: 8, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Communication, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Decision Making

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Solution: Auditors have liability under common law for addressing the client requirements.

182. Auditors have liability under _____ for addressing the requirements of third-party users of financial statements.
A. statutory law

Ans: N/A, LO: 9, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Communication, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Decision Making

Solution: Auditors have liability under statutory law for addressing the requirements of third-party users of financial statements.

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

Ans: N/A, LO: 9, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Decision Making

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

184. The _____ was the act passed in 2002 after the public was dissatisfied with the quality of audits of public companies.
A. Sarbanes-Oxley Act

Ans: N/A, LO: 9, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Professional Behavior

Solution: The public was not satisfied with the quality of audits of public companies. The result was the Sarbanes-Oxley Act of 2002 and the creation of the PCAOB to provide oversight of the auditors of public companies.

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

Ans: N/A, LO: 9, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Decision Making

Solution: The statutory law is established by the state and federal legislative bodies and specifically addresses the auditor's liability under certain circumstances.

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

Ans: N/A, LO: 9, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Communication. AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Decision Making

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

Question Type: Multiple choice multi select

187. In order to become a Certified Public Accountant (CPA) one must pass a professional examination and also fulfill the requisite experience requirements. Once a CPA has obtained his or her license, a CPA
A. may sign an audit or attest report, but is typically not allowed to sign a tax return as a tax preparer.
B. must abide by all professional standards and the AICPA code of conduct.
C. must keep their professional education current by obtaining the minimum required number of professional education courses each year.
D. is authorized to sign an audit report or an attest report, and may also sign a tax return as a tax preparer.

Ans: B, C, D, LO: 1, Bloom: Analysis, Difficulty: Medium, Min: 1, AACSB: Analytic, AICPA BB: None, AICPA FC: Reporting, AICPA PC: None

Solution: A CPA should abide by all professional standards, keep their professional education current, and may sign audit/attest reports as well as tax returns as a tax preparer

188. The AICPA Code of Professional Conduct has been incorporated by many states into state rules, and thus applies to CPAs who are practicing in those states. Which of the following statements are correct with respect to the AICPA Code of Professional Conduct?
A. The code consists of principles, rules and interpretations and other guidance for AICPA members.
B. Interpretations offer additional guidance regarding the scope and applicability of the rules of conduct, however practicing CPAs are free to depart from these interpretations without justification.
C. Rules of conduct establish minimum standards to help the CPA determine acceptable conduct in the performance of professional services.

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D. The code is organized into three major sections, beginning with Members in Business.

Ans: A, C, LO: 2, Bloom: Analysis, Difficulty: Medium, Min: 1, AACSB: Analytic, AICPA BB: None, AICPA FC: Reporting, AICPA PC: None

Solution: The code consists of principles, rules and interpretations and other guidance for AICPA members. Rules of conduct establish minimum standards to help the CPA determine acceptable conduct in the performance of professional services.

189. Juniper auditors are beginning the audit of Star Enterprises, a small business and new audit client for Juniper. It has been determined that one of Star Enterprises' key officers is the spouse of an audit manager that has been assigned to this client. In addition, Juniper has indicated that help will be needed in other areas such as providing bookkeeping services. Which of the choices below correctly represent the threats to independence that may exist in this situation?
   A. An advocacy threat may exist because the manager may not act objectively due to a potential conflict of interest.
   B. A familiarity threat may exist in that the manager may become too close to the audit client.
   C. A management participation threat may exist due to the client asking the auditor to perform extra services which may cause the CPA to make management decisions.
   D. An adverse interest threat may exist due to Juniper informing star that they are currently pursuing litigation against the predecessor auditor.

Ans: B, C, LO: 3, Bloom: Analysis, Difficulty: Medium, Min: 1, AACSB: Analytic, AICPA BB: None, AICPA FC: Reporting, AICPA PC: None

Solution: A familiarity threat may exist in that the manager may become too close to the audit client. A management participation threat may exist due to the client asking the auditor to perform extra services which may cause the CPA to make management decisions.

190. Starglow is a small CPA firm that specializes in auditing services to small and some medium size clients. Starglow is currently attempting to determine the best course of action to handle a conflict of interest case where Starglow is representing both the husband and wife in a divorce settlement case. Which of the options below would represent Starglows' correct choice of action?
   A. Upon realizing that they are representing both parties, Starglow should immediately advise both parties in writing of their intention to withdraw from the engagement.
   B. Starglow should determine if it can feasibly represent both clients and still maintain independence and objectivity, and if so, proceed with assisting and representing both clients.

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C. As Starglow is a smaller CPA firm, it may be required to withdraw representation to one of the parties in the divorce settlement case, in order to avoid a conflict of interest.
D. Starglow needs to simply advise both parties in writing of their representation of the other party, which will indemnify them against any future attempts at litigation by either party.

Ans: B, C, LO: 4, Bloom: Analysis, Difficulty: Medium, Min: 1, AACSB: Analytic, AICPA BB: None, AICPA FC: Reporting, AICPA PC: None

Solution: Starglow should determine if it can feasibly represent both clients and still maintain independence and objectivity, and if so, proceed with assisting and representing both clients. As Starglow is a smaller CPA firm, it may be required to withdraw representation to one of the parties in the divorce settlement case, in order to avoid a conflict of interest.

191. Identify two possible threats that occur when a CPA and his or her supervisor have a difference of opinion related to the application of accounting principles, auditing standards, or other relevant professional standards?
A. Self-interest
B. Advocacy
C. Familiarity
D. Self-review

Ans: A, C LO: 4, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Decision Making

Solution: Self-interest, familiarity, and undue influence threats may exist when a CPA and his or her supervisor have a difference of opinion related to the application of accounting principles, auditing standards, or other relevant professional standards.

192. When considering threats to auditor independence, an issue of extreme importance is that of covered members. Covered members represent persons in positions to potentially influence attest decisions and/or the outcome of an audit engagement. Select any of the following scenarios that may represent an impairment of independence to a covered member
A. A member of the audit engagement team assigned to a client has determined that he or she has a material indirect interest in the client under audit.
B. A different partner working in the same office as the partner assigned to the audit client, who has a loan outstanding with the audit client.
C. A nephew of an audit manager assigned to the audit client who owns shares of stock in the client.
D. A member of a compensation committee who has an indirect, immaterial interest in the audit client.

Ans: A, B, LO: 5, Bloom: Analysis, Difficulty: Medium, Min: 1, AACSB: Analytic, AICPA BB: None, AICPA FC: Reporting, AICPA PC: None

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Solution: A member of the audit engagement team assigned to a client has determined that he or she has a material indirect interest in the client under audit. A different partner working in the same office as the partner assigned to the audit client, and who has a loan outstanding with the audit client.

193. Greengrass auditors is determining whether to accept a new audit client, Breezy Inc. As part of its client acceptance procedure, Greengrass is attempting to evaluate whether the firm has the necessary expertise and competence to effectively audit Breezy, Inc. Some of the key considerations for Greengrass would include
   A. Ensuring that the audit, if accepted, can be undertaken and completed with professional competence.
   B. Obtaining enough information on the client to allow a subjective determination of whether professional services can be effectively performed.
   C. Ensure that if the audit client is accepted and the audit proceeds, adequate planning and supervision is possible with respect to the performance of professional services.
   D. All of the choices are correct.

Ans: D, LO: 6, Bloom: Analysis, Difficulty: Medium, Min: 1, AACSB: Analytic, AICPA BB: None, AICPA FC: Reporting, AICPA PC: None

Solution: All of these answer choices are correct.

194. With respect to CPAs in public practice, Rule 1.320 on accounting principles advises that CPAs should not knowingly express an affirmative audit opinion or state that he or she is not aware of any material modifications made to the financial statements if the opposite exists. Select all answer choices below which accurately describe the theories that underpin this rule
   A. A presumption that adherence to authoritative accounting principles promulgated by professional bodies would result in accurate financial statements.
   B. The option for the CPA to depart from the accounting principle, if he or she deems it appropriate, in order to achieve fair and accurate financial statement presentation.
   C. The belief that forcing CPAs to always abide by these principles will introduce an element of standardization and uniformity in financial statements and audit reports.
   D. To provide legal protection and indemnity to the auditor in case they are subject to litigation.

Ans: A, B, LO: 7, Bloom: Analysis, Difficulty: Medium, Min: 1, AACSB: Analytic, AICPA BB: None, AICPA FC: Reporting, AICPA PC: None

Solution: A presumption that adherence to authoritative accounting principles promulgated by professional bodies would result in accurate financial statements. The option for the CPA to depart from the accounting principle, if he or she deems it appropriate, in order to achieve fair and accurate financial statement presentation.

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195. Britannia External Auditors recently published an audit report which has become the focus of litigation. The plaintiff has alleged breach of contract on the part of the external auditor. Which of the following choices would represent viable options for the plaintiff to attempt to prove Britannia did indeed breach a contract?
   A. In the course of the audit, Britannia violated a confidentiality agreement with the client.
   B. Britannia had agreed to deliver the audit report in full on a predetermined specified date, and due to audit staff turnover, was not able to deliver on its promise.
   C. It has been alleged that Britannia may have issued a standard audit report which did not follow generally accepted auditing standards.
   D. All of the choices are correct.

Ans: D, LO: 8, Bloom: Analysis, Difficulty: Medium, Min: 1, AACSB: Analytic, AICPA BB: None, AICPA FC: Reporting, AICPA PC: None

Solution: All of these answer choices are correct.

196. Bluetooth External Auditors is currently engaged in the audit of Farmside Enterprises. During the audit, it has been determined that Farmside has conducted an initial offering of common stock in order to raise needed capital for expansion. Senior management of Farmside is attempting to understand their liability in this case. Select all responses below which accurately describe Bluetooth's best response.
   A. Initial stock offerings are regulated by the Securities Act of 1933. Under the provisions of this act, the auditor may also be liable for losses resulting from ordinary negligence.
   B. Initial stock offerings are regulated by the SEC act of 1934. Under the provisions of this act, the auditor may also be liable for losses resulting from gross negligence.
   C. The plaintiffs may be any person who acquired securities that were described in the firm's registration statement, regardless of whether or not they are a client of the auditor.
   D. Plaintiffs who purchased securities as part of initial offering need to prove reliance on the false or misleading statements in order to prevail in court.

Ans: A, C, LO: 9, Bloom: Analysis, Difficulty: Medium, Min: 1, AACSB: Analytic, AICPA BB: None, AICPA FC: Reporting, AICPA PC: None

Solution: Initial stock offerings are regulated by the Securities Act of 1933. Under the provisions of this act, the auditor may also be liable for losses resulting from ordinary negligence. The plaintiffs may be any person who acquired securities that were described in the firm's registration statement, regardless of whether or not they are a client of the auditor.

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Question Type: Drop down

197. Match each of the threats below with the appropriate description.
   A. Undue influence threat
      ||The threat that a CPA will subordinate his or her judgment to an individual associated with the client or a relevant third party.
   B. Self-interest threat
      ||The threat that a CPA could benefit from an interest in, or relationship with, a client or persons associated with a client.
   C. Management participation threat
      ||The threat that a CPA will take on the role of client leadership or assume such responsibilities.
   D. Adverse interest threat
      ||The threat that a CPA will not act with objectivity because the CPA's interests are opposed to client interests.

   Ans: 0, LO: 3, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Decision Making

   Solution: see below
   Self-interest threat—the threat that a CPA could benefit from an interest in, or relationship with, a client or persons associated with a client.
   Management participation threat—the threat that a CPA will take on the role of client leadership or assume such responsibilities.
   Adverse interest threat—the threat that a CPA will not act with objectivity because the CPA's interests are opposed to client interests.

198. Match the following entities with the appropriate categories.
   A. covered member
      ||member of the engagement team
   B. executor of an estate
      ||key management position
   C. nondependent children
      ||close relative
   D. dependent member
      ||immediate family member

   Ans: 0, LO: 5, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Decision Making

   Solution: A covered member may be a member of the engagement team. An executor of an estate holds a key management position. Nondependent children of a covered member are their close relatives. Dependent members of a covered member are their immediate family members.

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Question Type: Short Answer

199. Why do auditors try to achieve independence in appearance?
A. Auditors try to achieve independence in appearance in order to maintain public confidence in the profession.

Ans: N/A, LO 1, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Technology and Tools, AICPA PC: Decision Making

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

200. Stephen has recently obtained his CPA license and is getting ready to start a new job as CFO of a publicly-traded company. Stephen meets his friend Allen for coffee at a local coffee shop. Allen is curious about Stephen's new CPA license, and asks Stephen to explain what his obligations are under the new license and how important the license really is. Which of the following options best describes Stephen's response?

A. The CPA license is important because one must pass a rigorous professional exam and complete a work experience requirement before obtaining the license. After the license is obtained, a CPA is considered an expert and must prioritize his or her concern for the public interest.
B. The CPA license represents a prestigious certification for an individual to achieve in his or her career. Upon obtaining the license, firms are usually willing to higher wages and salaries, because stock prices and investor confidence in that company will always increase.
C. The CPA license is important because in addition to having to pass a rigorous professional exam and complete a work experience requirement, the CPA is responsible for ensuring that the goals and interests of the company and the public always align.
D. Becoming a CPA represents an embodiment of the public trust in that individual to always do the right thing in tough circumstances, and the public's expectation that the CPA will prioritize their obligation to their employer over accurate and fair presentation of the firm's financial statements.

Ans: A, LO: 1, Bloom: Analyze, Difficulty: Medium, Min: 1, AACSB: Analyze, AICPA BB: None, AICPA FC: Reporting, AICPA PC: None

Solution: The CPA license is important because one must pass a rigorous professional exam and complete a work experience requirement before obtaining the license. After the license is obtained, a CPA is considered an expert and must prioritize his or her concern for the public interest.

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201. Can a CPA who has never audited a commercial bank, audit the bank?
   A. The CPA may accept the engagement to audit the commercial bank after attaining a suitable level of understanding of the transactions and accounting practices unique to commercial banking.

Ans: N/A, LO 2, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Technology and Tools, AICPA PC: Decision Making

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

202. Jim, a recent college graduate, has recently obtained his CPA license. Jim has been contacted by the dean of a local college's school of business and asked to participate in a forum about the CPA license and what his responsibilities are as a CPA. During the forum, a student inquires as to whether Jim is required to abide by a code of conduct. Jim should respond with which of the following answers?
   A. The accounting profession has a code known as the AICPA Code of Professional Conduct. The code is split into principles, rules of conduct, and departures. A CPA must always follow these rules of conduct, and be prepared to justify any departures.
   B. The AICPA Code of Professional Conduct represent the rules that guide CPAs. This code is split into principles which provide basic tenets; rules of conduct which help establish minimum standards, and interpretations which can offer additional guidance. A CPA is required to be a member of the AICPA and expected to abide by the code of conduct in order to keep his or her license.
   C. The AICPA Code of Professional Conduct is designed to help CPAs in practice handle ethical conflicts and sets forth rules of conduct which should be followed. While membership of the AICPA is voluntary, it is fair to say that the majority, if not all CPAs should strive to abide by the code of conduct.
   D. The AICPA Code of Professional Conduct is voluntary, and thus the rules are practicable and certainly helpful to practicing CPAs, but not enforceable. The code is purposefully split into interpretations, principles, and a strict code of ethics.

Ans: C, LO: 2, Bloom: Analyze, Difficulty: Medium, Min: 1, AACSB: Ethics, AICPA BB: None, AICPA FC: Reporting, AICPA PC: None

Solution: The AICPA Code of Professional Conduct is designed to help CPAs in practice handle ethical conflicts and sets forth rules of conduct which should be followed. While membership of the AICPA is voluntary, it is fair to say that the majority, if not all CPAs should strive to abide by the code of conduct.

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203. Martha and Betty are both senior managers for a prominent local auditing firm. During the audit of a client that they are both working on, Martha and Betty are discussing the accounting conceptual framework and are deliberating on how the framework can be used to 'fill in the gaps' of the AICPA Code of Professional Conduct. Martha has been a CPA for many years, whereas Betty only recently obtained her licensure. Betty asks Martha to explain her understanding of the conceptual framework and how best to utilize this framework when faced with a particular challenging circumstance. Which of the following would be Martha's most appropriate response?

A. The framework represents a comprehensive body of accounting rules and principles which CPAs can refer to for guidance and assistance in areas of accounting and ethics. If a suitable course of action cannot be determined using the conceptual framework, the CPA should instead refer to the AICPA Code of Professional Conduct.
B. The framework represents an authoritative body of knowledge in the accounting profession, and is designed to help CPAs and other members of the accounting profession by providing guidance in a variety of areas. The framework is a great place for a CPA to look if suitable guidance cannot be found in the AICPA Code of Professional Conduct.
C. The framework is a useful tool for CPAs in practice, but its usage is optional. While many CPAs refer to the framework for guidance, others simply depart from its rules and provide justifications for doing so which creates an inconsistency in the profession.
D. The conceptual framework represents a useful tool for CPAs in practice, but many of the rules are so ambiguous CPAs rarely agree on their interpretation and application, thus the code is rarely used.

Ans: B, LO: 3, Bloom: Analyze, Difficulty: Medium, Min: 1, AACSB: Ethics, AICPA BB: None, AICPA FC: Reporting, AICPA PC: None

Solution: The framework represents an authoritative body of knowledge in the accounting profession, and is designed to help CPAs and other members of the accounting profession by providing guidance in a variety of areas. The framework is a great place for a CPA to look if suitable guidance cannot be found in the AICPA Code of Professional Conduct.

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204. Honey & Co. external auditors have recently accepted an attest engagement with a new client, Flower Enterprises. During the initial client meeting, top management of Flower Enterprises apprised the auditor that several key members of management had recently departed and were yet to be replaced, and as a result, management of Flower Enterprises would be leaning on the auditors for informal advice and guidance until these positions could be replaced with the appropriate expertise. One of the key departures was the head of Internal Audit. Upon learning this information, the external auditors convene a private meeting to discuss possible threats to independence. The outcomes of this meeting are likely to include
   A. an adverse interest threat may exist because it will be harder for the CPA to act objectively, and a familiarity threat may also exist because the external auditors will now have to make management decisions.
   B. a management participation threat is likely to exist due to the departure of several top managers, and a self-review threat is also likely to exist because with less key management in place, the CPA is more likely to have to review their own work as well as the work of the internal audit function.
   C. a self-review threat may exist because the CPA is likely to have to assume functions ordinarily performed by the client, and a management participation threat may exist because the CPA firm is essentially being asked to fill in for various empty management positions.
   D. an undue influence threat may exist due to the remaining members of the client's management asserting their positions and power, and an adverse interest threat may also exist because the CPA firm is likely to be less objective now that audit fees can be increased.

Ans: C, LO: 3, Bloom: Analyze, Difficulty: Medium, Min: 1, AACSB: Ethics, AICPA BB: None, AICPA FC: Reporting, AICPA PC: None

Solution: A self-review threat may exist because the CPA is likely to have to assume functions ordinarily performed by the client, and a management participation threat may exist because the CPA firm is essentially being asked to fill in for various empty management positions.

205. What is the conceptual difference between attestation standards and generally accepted auditing standards?
   A. Attestation standards provide a framework for the attest function beyond historical financial statements.

Ans: N/A, LO 3, Bloom: Knowledge, Difficulty: Easy, Min: 1, AACSB: Analytic, AICPA BB: Governance Perspective, AICPA FC: Technology and Tools, AICPA PC: Decision Making

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

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206. Tabletop External Auditors are currently completing the audit of Star Enterprises, Inc. a manufacturer of specialized astronomy and stargazing equipment with sales throughout the continental United States. In a recent meeting with Star Enterprises' top management, a difference of opinion was noted on the depreciation method Star Enterprises has been using for its factory equipment; currently the straight line method. Tabletop auditors convened a private meeting to include just the audit managers assigned to the audit to discuss this issue further. During this meeting, it came to light that three of the audit managers believe straight line depreciation is the most appropriate method and the other three audit managers believe double declining balance is more appropriate. The lead partner assigned to the engagement has been called in to settle the difference of opinion. Which of the choices below most accurately reflect the lead partner's decision process in arriving at the suitable method?

A. The lead partner assigned to the engagement is likely to attempt to determine if the straight line method of depreciation is causing a material misstatement in the financial statements, and if so, request it be changed to the double declining balance method to avoid future misstatements.
B. The lead partner assigned to the engagement is likely to advise all senior managers that choice of depreciation method is ultimately the clients to make, and thus the audit staff should simply audit the depreciation expenses to make sure they are correct.
C. If both depreciation methods are not likely to cause a potentially material misstatement in the financial statements, the lead partner will likely advise the audit managers to defer the decision to client management.
D. Per the AICPA Code of Professional Conduct, the lead partner is likely to take the concerns directly to the client's board of directors and request the issue be voted on and decided at the next board meeting.

Ans: A, LO: 4, Bloom: Analyze, Difficulty: Medium, Min: 1, AACSB: Ethics, AICPA BB: None, AICPA FC: Reporting, AICPA PC: None

Solution: The lead partner assigned to the engagement is likely to attempt to determine if the straight line method of depreciation is causing a material misstatement in the financial statements, and if so, request it be changed to the double declining balance method to avoid future misstatements.

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207. Sam and Dave are both audit partners in a medium-size CPA firm. Sam has recently joined the firm from another organization, and is being mentored by Dave, a much more experienced auditor and long-time CPA. One day, Sam and Dave are discussing the concept of covered members, which piques Sam's curiosity. Sam advises that while he understands the lists of who is and who isn't a covered member, he is not sure why only certain people are included and others are not. In answering this question and providing a broader conceptual understanding of what it means to be a covered member, Dave should advise which of the following?

A. It is important to understand that as a covered member, the CPA is now liable for any and all misstatements contained in the client's financial statements, whether or not they are discovered.
B. Restrictions related to covered members can be thought of as a safeguard to help people in certain positions of potential influence avoid conflicts of interest. This helps to maintain both independence in fact and independence in appearance.
C. Covered members can be thought of those people who, during a particular attest engagement, may be placed in a position where they have conflicting interests. When this happens, the covered member may continue working on the engagement but should disclose any potential conflict of interest immediately to avoid litigation.
D. As a covered member is considered to generally be anyone who can influence the outcome of an attest engagement or the decisions made during the engagement, a covered member or members of their family are strictly prohibited from holding any direct or indirect interest in an attest client.

Ans: B, LO: 5, Bloom: Analyze, Difficulty: Medium, Min: 1, AACSB: Ethics, AICPA BB: None, AICPA FC: Reporting, AICPA PC: None

Solution: Restrictions related to covered members can be thought of as a safeguard to help people in certain positions of potential influence avoid conflicts of interest. This helps to maintain both independence in fact and independence in appearance.

208. During the initial phases of the external audit of Dark Co., Light CPAs' audit managers and partners assigned to the engagement are discussing any potential conflicts of interest that may be present and need to be addressed. One of the audit managers advises that his wife has recently taken a job with Dark Co. and will be responsible for the client's data entry as well as being the petty cash custodian. Based on this information, what would be the most appropriate classification of both the audit manager and his wife?

A. The partners will likely conclude that the audit manager assigned to the audit is a covered member because of his involvement in the audit and ability to influence its outcome, and will likely also conclude that the audit manager's spouse is a covered member due to her involvement with the client's cash.

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B. The partners are likely to agree that the audit manager assigned to this audit is a covered member by virtue of the fact that he can influence the outcome of the engagement, and that his wife is likely not considered a key member because of the immateriality of the petty cash fund.
C. The partners are likely to conclude that the audit manager's spouse holds a key position with the client and thus the audit manager should be reassigned to a separate attest engagement forthwith.
D. It is probable that the audit partners will conclude that the audit managers' spouse does not hold a key position with the client due to the immateriality of the petty cash fund, and that the audit manager is not a covered person as the partners will ultimately make all important decisions.

Ans: B, LO: 5, Bloom: Analyze, Difficulty: Medium, Min: 1, AACSB: Ethics, AICPA BB: None, AICPA FC: Reporting, AICPA PC: None

Solution: The partners are likely to agree that the audit manager assigned to this audit is a covered member by virtue of the fact that he can influence the outcome of the engagement, and that his wife is likely not considered a key member because of the immateriality of the petty cash fund.

209. Ramsey external auditors are currently completing an attest engagement for Proctor Industries. Proctor is a medium size firm that specializes in Bluetooth technology equipment such as headphones and speakers. During one of the initial meetings with the client, it has come to light that a former audit partner that worked for Ramsey up until eight months ago is now employed by Proctor in the role of head of Internal Audit. The engagement team partners assigned responsibility for the audit are discussing how best to proceed. The most likely course of action for Ramsey to pursue is
A. to advise Proctor of this conflict of interest and signify their intention to withdraw from the engagement pursuant to rules contained in the AICPA Code of Professional Conduct to avoid any issues that may arise.
B. to immediately modify all procedures related to the audit to counter the familiarity the ex-employee has with the auditing firm and its procedures. If it is not possible or appropriate to make such modifications, the auditor should withdraw from the engagement.
C. to determine the level of familiarity the former employee had or may have of the audit procedures to be employed and determine if any revisions need to be made. Ramsey should also ensure that the same level of professional skepticism is applied to this individual as others working for the client.
D. to utilize the former employee as an unofficial source of information on the firm to help discover any areas of heightened risk within the firm.

Ans: C, LO: 5, Bloom: Analyze, Difficulty: Medium, Min: 1, AACSB: Ethics, AICPA BB: None, AICPA FC: Reporting, AICPA PC: None

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Solution: to determine the level of familiarity the former employee had or may have of the audit procedures to be employed and determine if any revisions need to be made. Ramsey should also ensure that the same level of professional skepticism is applied to this individual as others working for the client.

210. Apple external auditors has been busy auditing the financial statements of Orange Inc. a supplier of fresh orange and apple juice across the Midwestern United States. It has been observed by the auditors throughout the course of the engagement that Orange Inc. appears drastically understaffed in the accounting department. As a result of this, and in order to ensure the audit is completed on budget and on time, several of the junior staff members assigned to the audit have been helping out with basic accounting tasks such as inputting of journal entries and preparation of sales orders and bills of lading. During a recent discussion between the two partners assigned to the engagement, this issue has come up and is being discussed. The discussion between the two partners is likely to center around which of the following?

A. Whether or not Apple auditors can charge Orange Inc. more money as a result of the extra work the auditing firm staff are now having to perform, and if so, how best to include these extra fees as part of the cost of the audit.
B. Whether or not a potential impairment to independence may exist because of the auditing staff's involvement with the client's accounting function, and how this could be construed by the public at large.
C. That the audit staff's involvement in the client's accounting function does not represent a threat to independence because the audit staff are only performing menial and mostly immaterial accounting tasks.
D. Whether the partners should consider meeting with the client's top management to discuss further opportunities for the auditor's staff to assist the client in meeting deadlines and performing all functions necessary to ensure the audit is completed in a timely manner.

Ans: B, LO: 5, Bloom: Analyze, Difficulty: Medium, Min: 1, AACSB: Ethics, AICPA BB: None, AICPA FC: Reporting, AICPA PC: None

Solution: Whether or not a potential impairment to independence may exist because of the auditing staff's involvement with the client's accounting function, and how this could be construed by the public at large.

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211. Alan Johnson, an experienced CPA and auditor has recently retired from a long career in financial accounting. Upon retiring, Alan was approached by the board of directors of Trustman Company, a large distributor of medical device products and publicly-traded entity, and asked to join its audit committee. Alan accepts the offer. During the first meeting of the audit committee, a question is raised by another committee member as to the current external auditor's independence. It has been brought to the audit committee's attention that the external auditor is having to perform certain bookkeeping and actuarial functions on behalf of the client due to a lack of expertise on the client's staff. Which of the following would be Alan's best response when asked for his opinion on the matter?

A. Alan should respond that it is appropriate for the auditor to perform these services so long as the calculations and work is checked by a member of Trustman Company thereafter.
B. Alan should advise that while it is appropriate for the auditor to assist the client with these functions in the interim, an urgent effort should be made to fill these expertise gaps.
C. Alan should express concern with the external auditor performing these functions, explaining that in so doing, the auditor is being put in a position of having to audit its own work.
D. Alan should express concern with the external auditor performing these functions, as the public and regulatory agencies are more likely to view the auditor as being an advocate for the firm.

Ans: C, LO: 5, Bloom: Analyze, Difficulty: Medium, Min: 1, AACSB: Ethics, AICPA BB: None, AICPA FC: Reporting, AICPA PC: None

Solution: Alan should express concern with the external auditor performing these functions, explaining that in so doing, the auditor is being put in a position of having to audit its own work.

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

Ans: N/A, LO 5, Bloom: Evaluation, Difficulty: Hard, Min: 1, AACSB: Analytic, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Decision Making

Solution: see below

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

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

Ans: N/A, LO 6, Bloom: Synthesis, Difficulty: Hard, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Technology and Tools, AICPA PC: Decision Making

Solution: Students will submit different content here but the key points of their email responses should be to (1) thank Stephen for considering our firm, (2) respectively and politely decline the engagement, (3) explain why the engagement must be declined – we simply do not have the experience and knowledge necessary to complete the engagement within the required time frame, and (4) suggest another CPA who may be able to help Stephen.
The email response should reference the general standards: "A member shall comply with the following standards and with any interpretations thereof by bodies designated by Council:

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

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

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

Ans: N/A, LO 6, Bloom: Application, Difficulty: Medium, Min: 1, AACSB: Analytic, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Decision Making

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

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215. Beaver Auditing Inc. has been approached by the management of Igloo Enterprises, a regional maker of ice creams and other iced treats in the southeastern United States. Igloo Enterprises is searching for a new external auditor to complete its yearly financial statement audit. Beaver Auditing Inc. has recently lost a number of key and experienced staff to a competitor due to a better salary and benefits package and has been struggling to replace the lost expertise. The partners of Beaver Auditing Inc. are meeting to discuss whether or not they should accept this audit engagement. Which of the choices below would best represent concerns that Beaver's partners may have in accepting this audit?
   A. Beaver's partners may be concerned with the heightened risk that the audit client is new, and that as a result, there is an increased chance of the auditors missing a material misstatement in the financial statements.
   B. Beaver's partners are likely to be concerned that the firm may struggle to complete the engagement with professional competence due to expertise lacking in certain areas and may also be concerned as to whether this lack of expertise will cause a lack of due care.
   C. The partners may be concerned that due to a staffing shortage, the external auditors will be less likely to be able to collect sufficient relevant data, which in turn means decreased inherent risk and an increased likelihood of future litigation.
   D. The partners may be concerned about being able to complete the audit in the agreed-upon timeframe, which may result in the auditor's reliance on the internal audit function to complete the areas where expertise is lacking.

Ans: B, LO: 6, Bloom: Analyze, Difficulty: Medium, Min: 1, AACSB: Ethics, AICPA BB: None, AICPA FC: Reporting, AICPA PC: None

Solution: Beaver's partners are likely to be concerned that the firm may struggle to complete the engagement with professional competence due to expertise lacking in certain areas and may also be concerned as to whether this lack of expertise will cause a lack of due care.

216. Elaine and Denise, both partners in a CPA firm are discussing the accounting principles rule and how this rule is applicable to their business and the auditing profession in general. Elaine states that her understanding of the rule is to protect auditing companies from placing themselves in a position of increased litigation whereas Denise explains that her interpretation of the rule is that it is designed to help ensure that CPAs and auditing firms adhere to the principle and do not depart from it unless a clear justification can be made. Which of the two partners are correct and why?
   A. Elaine is correct because a CPA firm is more likely to experience issues with litigation if they do not strictly follow the rules as set forth.
   B. Denise is correct because the spirit of the rule is to help ensure that CPAs and auditing firms do not make false or misleading statements which could cause harm to the general public.

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C. Both Elaine and Denise are correct because when the rule is adhered to, it may help auditing firms to avoid litigation, as well as ensuring no false or misleading statements about the financial statements are made.
D. None of the choices is correct.

Ans: C, LO: 7, Bloom: Analyze, Difficulty: Medium, Min: 1, AACSB: Ethics, AICPA BB: None, AICPA FC: Reporting, AICPA PC: None

Solution: Both Elaine and Denise are correct because when the rule is adhered to, it may help auditing firms to avoid litigation, as well as ensuring no false or misleading statements about the financial statements are made.

217. HPI Auditing Firm has just received a subpoena in connection with auditing work performed in the previous year for one of its former attest clients, Slippery Inc. The subpoena has requested the furnishing of client information which is considered to be confidential by the external auditor. HPI has consulted their in-house legal expert to advise the best course of action in relation to this subpoena. Which of the following choices would represent the most likely and appropriate response from the auditor's in-house legal counsel?
A. The subpoena should be considered null and void on the grounds that HPU Auditing Firm no longer provides auditing and attestation services to this client.
B. The subpoena is enforceable so long as it is issued by a valid legal authority, and the requested client information should be furnished accordingly.
C. The subpoena is enforceable so long as it is issued by a valid legal authority, but the former attest client should be notified and permission received before the release of any client information.
D. The auditing firm's in-house legal counsel should respond to the legal authority issuing the subpoena within ten business days to advise that the auditor-attest client relationship is privileged, and thus no information can legally be shared.

Ans: B, LO: 7, Bloom: Analyze, Difficulty: Medium, Min: 1, AACSB: Ethics, AICPA BB: None, AICPA FC: Reporting, AICPA PC: None

Solution: The subpoena is enforceable so long as it is issued by a valid legal authority, and the requested client information should be furnished accordingly.

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

Ans: N/A, LO 7, Bloom: Synthesis, Difficulty: Hard, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Decision Making

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

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

Ans: N/A, LO 7, Bloom: Synthesis, Difficulty: Hard, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Decision Making

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

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

Ans: N/A, LO 7, Bloom: Synthesis, Difficulty: Hard, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Decision Making

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

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

Ans: N/A, LO 8, Bloom: Synthesis, Difficulty: Hard, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Decision Making

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

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

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

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

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

Ans: N/A, LO 8, Bloom: Evaluation, Difficulty: Hard, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Decision Making

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

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

Ans: N/A, LO 9, Bloom: Evaluation, Difficulty: Hard, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Decision Making

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

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

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

Ans: N/A, LO 9, Bloom: Evaluation, Difficulty: Hard, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Decision Making

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

- Bookkeeping or other services related to the accounting records or financial statements of the audit client
- Financial information systems design and implementation
- Appraisal or valuation services, fairness opinions, or contribution-in-kind reports
- Actuarial services
- Internal audit outsourcing services
- Management functions or human resources
- Broker or dealer, investment adviser, or investment banking services
- Legal services and expert services unrelated to the audit
- Any other service that the PCAOB determines, by regulation, is impermissible

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

Ans: N/A, LO 9, Bloom: Synthesis, Difficulty: Hard, Min: 1, AACSB: Ethics, AICPA BB: Governance Perspective, AICPA FC: Reporting, AICPA PC: Decision Making

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

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