Chapter 01

The Role of the Public Accountant in the American Economy

**True / False Questions**

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| 1. | Independent audits of today place more emphasis on sampling than did the audits of the 19th century.    True    False |

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| 2. | The American Institute of Certified Public Accountants issues CPA certificates and permits CPAs to practice.    True    False |

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| 3. | A company is either audited by the GAO or internal auditors, but not both.    True    False |

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| 4. | The SEC does not pass on the merits of the securities that are registered with the agency.    True    False |

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| 5. | The American Institute of Certified Public Accountants has the primary authority to establish accounting standards.    True    False |

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| 6. | An annual peer review is a requirement of the AICPA.    True    False |

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| 7. | Many small companies elect to have their financial statements reviewed by a CPA firm, rather than incur the cost of an audit.    True    False |

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| 8. | Staff assistants in CPA firms generally are responsible for planning and coordinating audit engagements.    True    False |

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| 9. | The Sarbanes-Oxley Act requires that auditors of certain publicly traded companies in the United States perform an integrated audit that includes providing assurance on both the financial statements and on compliance with laws and regulations.    True    False |

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| 10. | Auditing is frequently only a small part of the practice of local CPA firms.    True    False |

**Multiple Choice Questions**

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| 11. | A summary of findings rather than assurance is most likely to be included in a(n):      |  |  | | --- | --- | | A. | Agreed-upon procedures report. |  |  |  | | --- | --- | | B. | Compilation report. |  |  |  | | --- | --- | | C. | Examination report. |  |  |  | | --- | --- | | D. | Review report. | |

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| 12. | The Statements on Auditing Standards have been issued by the:      |  |  | | --- | --- | | A. | Auditing Standards Board. |  |  |  | | --- | --- | | B. | Financial Accounting Standards Board. |  |  |  | | --- | --- | | C. | Securities and Exchange Commission. |  |  |  | | --- | --- | | D. | Federal Bureau of Investigation. | |

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| 13. | The risk associated with a company's survival and profitability is referred to as:      |  |  | | --- | --- | | A. | Business Risk. |  |  |  | | --- | --- | | B. | Information Risk. |  |  |  | | --- | --- | | C. | Detection Risk. |  |  |  | | --- | --- | | D. | Control Risk. | |

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| 14. | Historically, which of the following has the AICPA been **most** concerned with providing?      |  |  | | --- | --- | | A. | Professional standards for CPAs. |  |  |  | | --- | --- | | B. | Professional guidance for regulating financial markets. |  |  |  | | --- | --- | | C. | Standards guiding the conduct of internal auditors. |  |  |  | | --- | --- | | D. | Staff support to Congress. | |

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| 15. | The organization charged with protecting investors and the public by requiring full disclosure of financial information by companies offering securities to the public is the:      |  |  | | --- | --- | | A. | Auditing Standards Board. |  |  |  | | --- | --- | | B. | Financial Accounting Standards Board. |  |  |  | | --- | --- | | C. | Government Accounting Standards Boards. |  |  |  | | --- | --- | | D. | Securities and Exchange Commission. | |

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| 16. | An engagement in which a CPA firm arranges for a critical review of its practices by another CPA firm is referred to as a(n):      |  |  | | --- | --- | | A. | Peer Review Engagement. |  |  |  | | --- | --- | | B. | Quality Control Engagement. |  |  |  | | --- | --- | | C. | Quality Assurance Engagement. |  |  |  | | --- | --- | | D. | Attestation Engagement. | |

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| 17. | The serially-numbered pronouncements issued by the Auditing Standards Board over a period of years are known as:      |  |  | | --- | --- | | A. | Auditing Statements of Position (ASPs). |  |  |  | | --- | --- | | B. | Accounting Series Releases (ASRs). |  |  |  | | --- | --- | | C. | Statements on Auditing Standards (SASs). |  |  |  | | --- | --- | | D. | Statements on Auditing Principles (SAPs). | |

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| 18. | The Government Accountability Office (GAO):      |  |  | | --- | --- | | A. | Is primarily concerned with rapid processing of all accounts payable incurred by the federal government. |  |  |  | | --- | --- | | B. | Conducts operational audits and reports the results to Congress. |  |  |  | | --- | --- | | C. | Is a multinational organization of professional accountants. |  |  |  | | --- | --- | | D. | Is primarily concerned with budgets and forecasts approved by the SEC. | |

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| 19. | The risk that information is misstated is referred to as:      |  |  | | --- | --- | | A. | Information risk. |  |  |  | | --- | --- | | B. | Inherent risk. |  |  |  | | --- | --- | | C. | Relative risk. |  |  |  | | --- | --- | | D. | Business risk. | |

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| 20. | The risk that a company will ***not*** be able to meet its obligations when they become due is an aspect of:      |  |  | | --- | --- | | A. | Information risk. |  |  |  | | --- | --- | | B. | Inherent risk. |  |  |  | | --- | --- | | C. | Relative risk. |  |  |  | | --- | --- | | D. | Business risk. | |

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| 21. | Which of the following attributes most clearly differentiates a CPA who audits management's financial statements as contrasted to management?      |  |  | | --- | --- | | A. | Integrity. |  |  |  | | --- | --- | | B. | Competence. |  |  |  | | --- | --- | | C. | Independence. |  |  |  | | --- | --- | | D. | Keeping informed on current professional developments. | |

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| 22. | The attest function:      |  |  | | --- | --- | | A. | Is an essential part of every engagement by the CPA, whether performing auditing, tax work, or other services. |  |  |  | | --- | --- | | B. | Includes the preparation of a report of the CPA's findings. |  |  |  | | --- | --- | | C. | Requires a consideration of internal control. |  |  |  | | --- | --- | | D. | Requires a complete review of all transactions during the period under examination. | |

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| 23. | Attestation risk is limited to a low level in which of the following engagement(s)?      |  |  | | --- | --- | | A. | Both examinations and reviews. |  |  |  | | --- | --- | | B. | Examinations, but not reviews. |  |  |  | | --- | --- | | C. | Reviews, but not examinations. |  |  |  | | --- | --- | | D. | Neither examinations nor reviews. | |

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| 24. | When compared to an audit performed prior to 1900, an audit today:      |  |  | | --- | --- | | A. | Is more likely to include tests of compliance with laws and regulations. |  |  |  | | --- | --- | | B. | Is less likely to include consideration of the effectiveness of internal control. |  |  |  | | --- | --- | | C. | Has bank loan officers as the primary financial statement user group. |  |  |  | | --- | --- | | D. | Includes a more detailed examination of all individual transactions. | |

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| 25. | Which of the following are issued by the Securities and Exchange Commission?      |  |  | | --- | --- | | A. | Accounting Research Studies. |  |  |  | | --- | --- | | B. | Accounting Trends and Techniques. |  |  |  | | --- | --- | | C. | Industry Audit Guides. |  |  |  | | --- | --- | | D. | Financial Reporting Releases. | |

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| 26. | Which of the following is not correct relating to the Sarbanes-Oxley Act?      |  |  | | --- | --- | | A. | It toughens penalties for corporate fraud. |  |  |  | | --- | --- | | B. | It restricts the types of consulting CPAs may perform for audit clients. |  |  |  | | --- | --- | | C. | It created the Public Company Accounting Oversight Board (PCAOB) as a replacement for the Financial Accounting Standards Board. |  |  |  | | --- | --- | | D. | It eliminates a significant portion of the accounting profession's system of self-regulation. | |

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| 27. | An operational audit differs in many ways from an audit of financial statements. Which of the following is the best example of one of these differences?      |  |  | | --- | --- | | A. | The usual audit of financial statements covers the four basic statements, whereas the operational audit is usually limited to either the balance sheet or the income statement. |  |  |  | | --- | --- | | B. | The boundaries of an operational audit are often drawn from an organization chart and are not limited to a single accounting period. |  |  |  | | --- | --- | | C. | Operational audits do not ordinarily result in the preparation of a report. |  |  |  | | --- | --- | | D. | The operational audit deals with pre-tax income. | |

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| 28. | The review of a company's financial statements by a CPA firm:      |  |  | | --- | --- | | A. | Is substantially less in scope of procedures than an audit. |  |  |  | | --- | --- | | B. | Requires detailed analysis of the major accounts. |  |  |  | | --- | --- | | C. | Is of similar scope as an audit and adds similar credibility to the statements. |  |  |  | | --- | --- | | D. | Culminates in issuance of a report expressing the CPA's opinion as to the fairness of the statements. | |

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| 29. | Which statement is correct with respect to continuing professional education (CPE) requirements of members of the AICPA?      |  |  | | --- | --- | | A. | Only members employed by the AICPA are required to take such courses. |  |  |  | | --- | --- | | B. | Only members in public practice are required to take such courses. |  |  |  | | --- | --- | | C. | Members, regardless of whether they are in public practice, are required to meet such requirements. |  |  |  | | --- | --- | | D. | There is no requirement for members to participate in CPE. | |

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| 30. | The FDIC Improvement Act requires that management of large financial institutions engage auditors to attest to assertions by management about the effectiveness of the institution's internal controls over:      |  |  | | --- | --- | | A. | Compliance with laws and regulations. |  |  |  | | --- | --- | | B. | Financial reporting. |  |  |  | | --- | --- | | C. | Effectiveness of operations. |  |  |  | | --- | --- | | D. | Efficiency of operations. | |

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| 31. | Passage of the Sarbanes-Oxley Act led to the establishment of the:      |  |  | | --- | --- | | A. | Auditing Standards Board. |  |  |  | | --- | --- | | B. | Accounting Enforcement Releases Board. |  |  |  | | --- | --- | | C. | Public Company Accounting Oversight Board. |  |  |  | | --- | --- | | D. | Securities and Exchange Commission. | |

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| 32. | Which of the following professionals has primary responsibility for the performance of an audit?      |  |  | | --- | --- | | A. | The managing partner of the firm. |  |  |  | | --- | --- | | B. | The senior assigned to the engagement. |  |  |  | | --- | --- | | C. | The manager assigned to the engagement. |  |  |  | | --- | --- | | D. | The partner in charge of the engagement. | |

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| 33. | Which of the following types of services is generally provided only by CPA firms?      |  |  | | --- | --- | | A. | Tax audits. |  |  |  | | --- | --- | | B. | Financial statement audits. |  |  |  | | --- | --- | | C. | Compliance audits. |  |  |  | | --- | --- | | D. | Operational audits. | |

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| 34. | The right to practice as a CPA is given by which of the following organizations?      |  |  | | --- | --- | | A. | State Boards of Accountancy. |  |  |  | | --- | --- | | B. | The AICPA. |  |  |  | | --- | --- | | C. | The SEC. |  |  |  | | --- | --- | | D. | The General Accounting Office. | |

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| 35. | Which of the following terms best describes the audit of a taxpayer's tax return by an IRS auditor?      |  |  | | --- | --- | | A. | Operational audit. |  |  |  | | --- | --- | | B. | Internal audit. |  |  |  | | --- | --- | | C. | Compliance audit. |  |  |  | | --- | --- | | D. | Government audit. | |

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| 36. | Inquiries and analytical procedures ordinarily form the basis for which type of engagement?      |  |  | | --- | --- | | A. | Agreed-upon procedures. |  |  |  | | --- | --- | | B. | Audit. |  |  |  | | --- | --- | | C. | Examination. |  |  |  | | --- | --- | | D. | Review. | |

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| 37. | Which of the following best describes the reason why independent auditors report on financial statements?      |  |  | | --- | --- | | A. | A management fraud may exist and it is more likely to be detected by independent auditors. |  |  |  | | --- | --- | | B. | Different interests may exist between the company preparing the statements and the persons using the statements. |  |  |  | | --- | --- | | C. | A misstatement of account balances may exist and is generally corrected as the result of the independent auditors' work. |  |  |  | | --- | --- | | D. | Poorly designed internal control may be in existence. | |

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| 38. | Governmental auditing often extends beyond examinations leading to the expression of opinion on the fairness of financial presentation and includes audits of efficiency, economy, effectiveness, and also:      |  |  | | --- | --- | | A. | Accuracy. |  |  |  | | --- | --- | | B. | Evaluation. |  |  |  | | --- | --- | | C. | Compliance. |  |  |  | | --- | --- | | D. | Internal control. | |

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| 39. | Operational auditing is primarily oriented toward:      |  |  | | --- | --- | | A. | Future improvements to accomplish the goals of management. |  |  |  | | --- | --- | | B. | The accuracy of data reflected in management's financial records. |  |  |  | | --- | --- | | C. | The verification that a company's financial statements are fairly presented. |  |  |  | | --- | --- | | D. | Past protection provided by existing internal control. | |

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| 40. | A typical objective of an operational audit is for the auditor to:      |  |  | | --- | --- | | A. | Determine whether the financial statements fairly present the entity's operations. |  |  |  | | --- | --- | | B. | Evaluate the feasibility of attaining the entity's operational objectives. |  |  |  | | --- | --- | | C. | Make recommendations for improving performance. |  |  |  | | --- | --- | | D. | Report on the entity's relative success in attaining profit maximization. | |

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| 41. | An integrated audit performed under the Sarbanes-Oxley Act requires that auditors report on:          |  |  | | --- | --- | | A. | Option A |  |  |  | | --- | --- | | B. | Option B |  |  |  | | --- | --- | | C. | Option C |  |  |  | | --- | --- | | D. | Option D | |

**Matching Questions**

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| 42. | Accountants are regulated by a variety of organizations. Match the following statements with the most directly related organizations. Organizations may be used once or not at all.      |  |  |  | | --- | --- | --- | | 1. Formed to improve standards of financial accounting for state and local government entities | State Boards of Accountancy. | \_\_\_\_ | | 2. Issue CPA certificates | Government Accounting Standards Board. | \_\_\_\_ | | 3. Develop accounting standards for public and nonpublic companies | American Institute of Certified Public Accountants. | \_\_\_\_ | | 4. Develop accounting standards for the U.S. Government | Financial Accounting Standards Board. | \_\_\_\_ | | 5. Issue auditing standards for public companies | Federal Accounting Standards Advisory Board. | \_\_\_\_ | | 6. Prepares the CPA exam | Public Company Accounting Oversight Board. | \_\_\_\_ | |

**Essay Questions**

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| 43. | The Sarbanes-Oxley Act of 2002 made significant reforms for public companies and their auditors.  a. Describe the events that led up to the passage of the Act. b. Describe the major changes made by the Act. |

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| 44. | Many people confuse the responsibilities of the independent auditors and the client's management with respect to audited financial statements.  a. Describe management's responsibility regarding audited financial statements. b. Describe the independent auditors' responsibility regarding audited financial statements. c. Evaluate the following statement: "If the auditors disagree with management regarding an accounting principle used in the financial statements the auditors should express their views in the notes to the financial statements." |

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| 45. | An investor is considering investing in one of two companies. The companies have very similar reported financial position and results of operations. However, only one of the companies has its financial statements audited.  a. Describe what creates the demand for an audit in this situation. Include a discussion of how audited financial statements facilitate this investment transaction, and the effect of the audit on business risk and information risk. b. Identify the potential consequences to the company of not having its financial statements audited. |

Chapter 01 The Role of the Public Accountant in the American Economy Answer Key

**True / False Questions**

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| 1. | Independent audits of today place more emphasis on sampling than did the audits of the 19th century.    **TRUE** |

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| *AACSB: Analytic AICPA BB: Industry AICPA FN: Decision Making Blooms: Remember Difficulty: 2 Medium Learning Objective: 01-04 Explain why audits are demanded by society. Topic: Financial Statement Audits* |

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| 2. | The American Institute of Certified Public Accountants issues CPA certificates and permits CPAs to practice.    **FALSE** |

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| *AACSB: Analytic AICPA BB: Industry AICPA FN: Decision Making Blooms: Remember Difficulty: 2 Medium Learning Objective: 01-07 Explain the regulatory process for auditors of public companies and auditors of nonpublic companies. Topic: Public Accounting Profession* |

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| 3. | A company is either audited by the GAO or internal auditors, but not both.    **FALSE** |

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| *AACSB: Analytic AICPA BB: Industry AICPA FN: Decision Making Blooms: Remember Difficulty: 1 Easy Learning Objective: 01-06 Contrast the various types of audits and types of auditors. Topic: Financial Statement Audits* |

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| 4. | The SEC does not pass on the merits of the securities that are registered with the agency.    **TRUE** |

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| *AACSB: Analytic AICPA BB: Industry AICPA FN: Decision Making Blooms: Remember Difficulty: 2 Medium Learning Objective: 01-07 Explain the regulatory process for auditors of public companies and auditors of nonpublic companies. Topic: Public Accounting Profession* |

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| 5. | The American Institute of Certified Public Accountants has the primary authority to establish accounting standards.    **FALSE** |

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| *AACSB: Analytic AICPA BB: Industry AICPA FN: Decision Making Blooms: Remember Difficulty: 1 Easy Learning Objective: 01-07 Explain the regulatory process for auditors of public companies and auditors of nonpublic companies. Topic: Public Accounting Profession* |

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| 6. | An annual peer review is a requirement of the AICPA.    **FALSE** |

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| *AACSB: Analytic AICPA BB: Industry AICPA FN: Decision Making Blooms: Remember Difficulty: 2 Medium Learning Objective: 01-07 Explain the regulatory process for auditors of public companies and auditors of nonpublic companies. Topic: Public Accounting Profession* |

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| 7. | Many small companies elect to have their financial statements reviewed by a CPA firm, rather than incur the cost of an audit.    **TRUE** |

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| *AACSB: Analytic AICPA BB: Industry AICPA FN: Decision Making Blooms: Remember Difficulty: 1 Easy Learning Objective: 01-07 Explain the regulatory process for auditors of public companies and auditors of nonpublic companies. Topic: Public Accounting Profession* |

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| 8. | Staff assistants in CPA firms generally are responsible for planning and coordinating audit engagements.    **FALSE** |

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| *AACSB: Analytic AICPA BB: Industry AICPA FN: Decision Making Blooms: Remember Difficulty: 1 Easy Learning Objective: 01-08 Describe how public accounting firms are typically organized and the responsibilities of auditors at the various levels in the organization. Topic: Public Accounting Profession* |

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| 9. | The Sarbanes-Oxley Act requires that auditors of certain publicly traded companies in the United States perform an integrated audit that includes providing assurance on both the financial statements and on compliance with laws and regulations.    **FALSE** |

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| *AACSB: Analytic AICPA BB: Industry AICPA FN: Decision Making Blooms: Remember Difficulty: 2 Medium Learning Objective: 01-06 Contrast the various types of audits and types of auditors. Topic: Financial Statement Audits* |

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| 10. | Auditing is frequently only a small part of the practice of local CPA firms.    **TRUE** |

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| *AACSB: Analytic AICPA BB: Industry AICPA FN: Decision Making Blooms: Remember Difficulty: 2 Medium Learning Objective: 01-08 Describe how public accounting firms are typically organized and the responsibilities of auditors at the various levels in the organization. Topic: Public Accounting Profession* |

**Multiple Choice Questions**

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| 11. | A summary of findings rather than assurance is most likely to be included in a(n):      |  |  | | --- | --- | | **A.** | Agreed-upon procedures report. |  |  |  | | --- | --- | | B. | Compilation report. |  |  |  | | --- | --- | | C. | Examination report. |  |  |  | | --- | --- | | D. | Review report. | |

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| *AACSB: Analytic AICPA BB: Industry AICPA FN: Decision Making Blooms: Remember Difficulty: 2 Medium Learning Objective: 01-02 Identify assurance services that involve attestation. Topic: Attest Function* |

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| 12. | The Statements on Auditing Standards have been issued by the:      |  |  | | --- | --- | | **A.** | Auditing Standards Board. |  |  |  | | --- | --- | | B. | Financial Accounting Standards Board. |  |  |  | | --- | --- | | C. | Securities and Exchange Commission. |  |  |  | | --- | --- | | D. | Federal Bureau of Investigation. | |

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| *AACSB: Analytic AICPA BB: Industry AICPA FN: Decision Making Blooms: Remember Difficulty: 1 Easy Learning Objective: 01-07 Explain the regulatory process for auditors of public companies and auditors of nonpublic companies. Topic: Public Accounting Profession* |

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| 13. | The risk associated with a company's survival and profitability is referred to as:      |  |  | | --- | --- | | **A.** | Business Risk. |  |  |  | | --- | --- | | B. | Information Risk. |  |  |  | | --- | --- | | C. | Detection Risk. |  |  |  | | --- | --- | | D. | Control Risk. | |

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| *AACSB: Analytic AICPA BB: Industry AICPA FN: Decision Making Blooms: Remember Difficulty: 1 Easy Learning Objective: 01-04 Explain why audits are demanded by society. Topic: Financial Statement Audits* |

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| 14. | Historically, which of the following has the AICPA been **most** concerned with providing?      |  |  | | --- | --- | | **A.** | Professional standards for CPAs. |  |  |  | | --- | --- | | B. | Professional guidance for regulating financial markets. |  |  |  | | --- | --- | | C. | Standards guiding the conduct of internal auditors. |  |  |  | | --- | --- | | D. | Staff support to Congress. | |

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| *AACSB: Analytic AICPA BB: Industry AICPA FN: Decision Making Blooms: Remember Difficulty: 2 Medium Learning Objective: 01-07 Explain the regulatory process for auditors of public companies and auditors of nonpublic companies. Topic: Public Accounting Profession* |

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| 15. | The organization charged with protecting investors and the public by requiring full disclosure of financial information by companies offering securities to the public is the:      |  |  | | --- | --- | | A. | Auditing Standards Board. |  |  |  | | --- | --- | | B. | Financial Accounting Standards Board. |  |  |  | | --- | --- | | C. | Government Accounting Standards Boards. |  |  |  | | --- | --- | | **D.** | Securities and Exchange Commission. | |

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| *AACSB: Analytic AICPA BB: Industry AICPA FN: Decision Making Blooms: Remember Difficulty: 2 Medium Learning Objective: 01-07 Explain the regulatory process for auditors of public companies and auditors of nonpublic companies. Topic: Public Accounting Profession* |

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| 16. | An engagement in which a CPA firm arranges for a critical review of its practices by another CPA firm is referred to as a(n):      |  |  | | --- | --- | | **A.** | Peer Review Engagement. |  |  |  | | --- | --- | | B. | Quality Control Engagement. |  |  |  | | --- | --- | | C. | Quality Assurance Engagement. |  |  |  | | --- | --- | | D. | Attestation Engagement. | |

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| *AACSB: Analytic AICPA BB: Industry AICPA FN: Decision Making Blooms: Remember Difficulty: 1 Easy Learning Objective: 01-07 Explain the regulatory process for auditors of public companies and auditors of nonpublic companies. Topic: Public Accounting Profession* |

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| 17. | The serially-numbered pronouncements issued by the Auditing Standards Board over a period of years are known as:      |  |  | | --- | --- | | A. | Auditing Statements of Position (ASPs). |  |  |  | | --- | --- | | B. | Accounting Series Releases (ASRs). |  |  |  | | --- | --- | | **C.** | Statements on Auditing Standards (SASs). |  |  |  | | --- | --- | | D. | Statements on Auditing Principles (SAPs). | |

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| *AACSB: Analytic AICPA BB: Industry AICPA FN: Decision Making Blooms: Remember Difficulty: 1 Easy Learning Objective: 01-07 Explain the regulatory process for auditors of public companies and auditors of nonpublic companies. Topic: Public Accounting Profession* |

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| 18. | The Government Accountability Office (GAO):      |  |  | | --- | --- | | A. | Is primarily concerned with rapid processing of all accounts payable incurred by the federal government. |  |  |  | | --- | --- | | **B.** | Conducts operational audits and reports the results to Congress. |  |  |  | | --- | --- | | C. | Is a multinational organization of professional accountants. |  |  |  | | --- | --- | | D. | Is primarily concerned with budgets and forecasts approved by the SEC. | |

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| *AACSB: Analytic AICPA BB: Industry AICPA FN: Decision Making Blooms: Remember Difficulty: 1 Easy Learning Objective: 01-06 Contrast the various types of audits and types of auditors. Topic: Financial Statement Audits* |

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| 19. | The risk that information is misstated is referred to as:      |  |  | | --- | --- | | **A.** | Information risk. |  |  |  | | --- | --- | | B. | Inherent risk. |  |  |  | | --- | --- | | C. | Relative risk. |  |  |  | | --- | --- | | D. | Business risk. | |

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| *AACSB: Analytic AICPA BB: Industry AICPA FN: Decision Making Blooms: Remember Difficulty: 1 Easy Learning Objective: 01-04 Explain why audits are demanded by society. Topic: Financial Statement Audits* |

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| 20. | The risk that a company will ***not*** be able to meet its obligations when they become due is an aspect of:      |  |  | | --- | --- | | A. | Information risk. |  |  |  | | --- | --- | | B. | Inherent risk. |  |  |  | | --- | --- | | C. | Relative risk. |  |  |  | | --- | --- | | **D.** | Business risk. | |

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| *AACSB: Analytic AICPA BB: Industry AICPA FN: Decision Making Blooms: Remember Difficulty: 1 Easy Learning Objective: 01-04 Explain why audits are demanded by society. Topic: Financial Statement Audits* |

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| 21. | Which of the following attributes most clearly differentiates a CPA who audits management's financial statements as contrasted to management?      |  |  | | --- | --- | | A. | Integrity. |  |  |  | | --- | --- | | B. | Competence. |  |  |  | | --- | --- | | **C.** | Independence. |  |  |  | | --- | --- | | D. | Keeping informed on current professional developments. | |

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| *AACSB: Analytic AICPA BB: Industry AICPA FN: Decision Making Blooms: Remember Difficulty: 1 Easy Learning Objective: 01-01 Describe the nature of assurance services. Topic: Assurance Services* |

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| 22. | The attest function:      |  |  | | --- | --- | | A. | Is an essential part of every engagement by the CPA, whether performing auditing, tax work, or other services. |  |  |  | | --- | --- | | **B.** | Includes the preparation of a report of the CPA's findings. |  |  |  | | --- | --- | | C. | Requires a consideration of internal control. |  |  |  | | --- | --- | | D. | Requires a complete review of all transactions during the period under examination. | |

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| *AACSB: Analytic AICPA BB: Industry AICPA FN: Decision Making Blooms: Remember Difficulty: 2 Medium Learning Objective: 01-02 Identify assurance services that involve attestation. Topic: Attest Function* |

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| 23. | Attestation risk is limited to a low level in which of the following engagement(s)?      |  |  | | --- | --- | | A. | Both examinations and reviews. |  |  |  | | --- | --- | | **B.** | Examinations, but not reviews. |  |  |  | | --- | --- | | C. | Reviews, but not examinations. |  |  |  | | --- | --- | | D. | Neither examinations nor reviews. | |

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| *AACSB: Analytic AICPA BB: Industry AICPA FN: Decision Making Blooms: Remember Difficulty: 1 Easy Learning Objective: 01-02 Identify assurance services that involve attestation. Topic: Attest Function* |

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| 24. | When compared to an audit performed prior to 1900, an audit today:      |  |  | | --- | --- | | **A.** | Is more likely to include tests of compliance with laws and regulations. |  |  |  | | --- | --- | | B. | Is less likely to include consideration of the effectiveness of internal control. |  |  |  | | --- | --- | | C. | Has bank loan officers as the primary financial statement user group. |  |  |  | | --- | --- | | D. | Includes a more detailed examination of all individual transactions. | |

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| *AACSB: Analytic AICPA BB: Industry AICPA FN: Decision Making Blooms: Remember Difficulty: 2 Medium Learning Objective: 01-04 Explain why audits are demanded by society. Topic: Financial Statement Audits* |

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| 25. | Which of the following are issued by the Securities and Exchange Commission?      |  |  | | --- | --- | | A. | Accounting Research Studies. |  |  |  | | --- | --- | | B. | Accounting Trends and Techniques. |  |  |  | | --- | --- | | C. | Industry Audit Guides. |  |  |  | | --- | --- | | **D.** | Financial Reporting Releases. | |

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| *AACSB: Analytic AICPA BB: Industry AICPA FN: Decision Making Blooms: Remember Difficulty: 2 Medium Learning Objective: 01-07 Explain the regulatory process for auditors of public companies and auditors of nonpublic companies. Topic: Public Accounting Profession* |

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| 26. | Which of the following is not correct relating to the Sarbanes-Oxley Act?      |  |  | | --- | --- | | A. | It toughens penalties for corporate fraud. |  |  |  | | --- | --- | | B. | It restricts the types of consulting CPAs may perform for audit clients. |  |  |  | | --- | --- | | **C.** | It created the Public Company Accounting Oversight Board (PCAOB) as a replacement for the Financial Accounting Standards Board. |  |  |  | | --- | --- | | D. | It eliminates a significant portion of the accounting profession's system of self-regulation. | |

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| *AACSB: Analytic AICPA BB: Industry AICPA FN: Decision Making Blooms: Remember Difficulty: 2 Medium Learning Objective: 01-05 Describe how the credibility of the accounting profession was affected by the large number of companies reporting accounting irregularities in the beginning of this century. Topic: Financial Statement Audits* |

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| 27. | An operational audit differs in many ways from an audit of financial statements. Which of the following is the best example of one of these differences?      |  |  | | --- | --- | | A. | The usual audit of financial statements covers the four basic statements, whereas the operational audit is usually limited to either the balance sheet or the income statement. |  |  |  | | --- | --- | | **B.** | The boundaries of an operational audit are often drawn from an organization chart and are not limited to a single accounting period. |  |  |  | | --- | --- | | C. | Operational audits do not ordinarily result in the preparation of a report. |  |  |  | | --- | --- | | D. | The operational audit deals with pre-tax income. | |

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| *AACSB: Analytic AICPA BB: Industry AICPA FN: Decision Making Blooms: Remember Difficulty: 2 Medium Learning Objective: 01-06 Contrast the various types of audits and types of auditors. Topic: Financial Statement Audits* |

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| 28. | The review of a company's financial statements by a CPA firm:      |  |  | | --- | --- | | **A.** | Is substantially less in scope of procedures than an audit. |  |  |  | | --- | --- | | B. | Requires detailed analysis of the major accounts. |  |  |  | | --- | --- | | C. | Is of similar scope as an audit and adds similar credibility to the statements. |  |  |  | | --- | --- | | D. | Culminates in issuance of a report expressing the CPA's opinion as to the fairness of the statements. | |

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| *AACSB: Analytic AICPA BB: Industry AICPA FN: Decision Making Blooms: Remember Difficulty: 1 Easy Learning Objective: 01-02 Identify assurance services that involve attestation. Topic: Attest Function* |

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| 29. | Which statement is correct with respect to continuing professional education (CPE) requirements of members of the AICPA?      |  |  | | --- | --- | | A. | Only members employed by the AICPA are required to take such courses. |  |  |  | | --- | --- | | B. | Only members in public practice are required to take such courses. |  |  |  | | --- | --- | | **C.** | Members, regardless of whether they are in public practice, are required to meet such requirements. |  |  |  | | --- | --- | | D. | There is no requirement for members to participate in CPE. | |

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| *AACSB: Analytic AICPA BB: Industry AICPA FN: Decision Making Blooms: Remember Difficulty: 2 Medium Learning Objective: 01-07 Explain the regulatory process for auditors of public companies and auditors of nonpublic companies. Topic: Public Accounting Profession* |

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| 30. | The FDIC Improvement Act requires that management of large financial institutions engage auditors to attest to assertions by management about the effectiveness of the institution's internal controls over:      |  |  | | --- | --- | | A. | Compliance with laws and regulations. |  |  |  | | --- | --- | | **B.** | Financial reporting. |  |  |  | | --- | --- | | C. | Effectiveness of operations. |  |  |  | | --- | --- | | D. | Efficiency of operations. | |

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| *AACSB: Analytic AICPA BB: Industry AICPA FN: Decision Making Blooms: Remember Difficulty: 2 Medium Learning Objective: 01-04 Explain why audits are demanded by society. Topic: Financial Statement Audits* |

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| 31. | Passage of the Sarbanes-Oxley Act led to the establishment of the:      |  |  | | --- | --- | | A. | Auditing Standards Board. |  |  |  | | --- | --- | | B. | Accounting Enforcement Releases Board. |  |  |  | | --- | --- | | **C.** | Public Company Accounting Oversight Board. |  |  |  | | --- | --- | | D. | Securities and Exchange Commission. | |

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| *AACSB: Analytic AICPA BB: Industry AICPA FN: Decision Making Blooms: Remember Difficulty: 2 Medium Learning Objective: 01-05 Describe how the credibility of the accounting profession was affected by the large number of companies reporting accounting irregularities in the beginning of this century. Topic: Financial Statement Audits* |

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| 32. | Which of the following professionals has primary responsibility for the performance of an audit?      |  |  | | --- | --- | | A. | The managing partner of the firm. |  |  |  | | --- | --- | | B. | The senior assigned to the engagement. |  |  |  | | --- | --- | | C. | The manager assigned to the engagement. |  |  |  | | --- | --- | | **D.** | The partner in charge of the engagement. | |

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| *AACSB: Analytic AICPA BB: Industry AICPA FN: Decision Making Blooms: Remember Difficulty: 2 Medium Learning Objective: 01-08 Describe how public accounting firms are typically organized and the responsibilities of auditors at the various levels in the organization. Topic: Public Accounting Profession* |

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| 33. | Which of the following types of services is generally provided only by CPA firms?      |  |  | | --- | --- | | A. | Tax audits. |  |  |  | | --- | --- | | **B.** | Financial statement audits. |  |  |  | | --- | --- | | C. | Compliance audits. |  |  |  | | --- | --- | | D. | Operational audits. | |

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| *AACSB: Analytic AICPA BB: Industry AICPA FN: Decision Making Blooms: Remember Difficulty: 2 Medium Learning Objective: 01-02 Identify assurance services that involve attestation. Topic: Attest Function* |

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| 34. | The right to practice as a CPA is given by which of the following organizations?      |  |  | | --- | --- | | **A.** | State Boards of Accountancy. |  |  |  | | --- | --- | | B. | The AICPA. |  |  |  | | --- | --- | | C. | The SEC. |  |  |  | | --- | --- | | D. | The General Accounting Office. | |

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| *AACSB: Analytic AICPA BB: Industry AICPA FN: Decision Making Blooms: Remember Difficulty: 2 Medium Learning Objective: 01-07 Explain the regulatory process for auditors of public companies and auditors of nonpublic companies. Topic: Public Accounting Profession* |

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| 35. | Which of the following terms best describes the audit of a taxpayer's tax return by an IRS auditor?      |  |  | | --- | --- | | A. | Operational audit. |  |  |  | | --- | --- | | B. | Internal audit. |  |  |  | | --- | --- | | **C.** | Compliance audit. |  |  |  | | --- | --- | | D. | Government audit. | |

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| *AACSB: Analytic AICPA BB: Industry AICPA FN: Decision Making Blooms: Remember Difficulty: 2 Medium Learning Objective: 01-06 Contrast the various types of audits and types of auditors. Topic: Financial Statement Audits* |

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| 36. | Inquiries and analytical procedures ordinarily form the basis for which type of engagement?      |  |  | | --- | --- | | A. | Agreed-upon procedures. |  |  |  | | --- | --- | | B. | Audit. |  |  |  | | --- | --- | | C. | Examination. |  |  |  | | --- | --- | | **D.** | Review. | |

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| *AACSB: Analytic AICPA BB: Industry AICPA FN: Decision Making Blooms: Remember Difficulty: 1 Easy Learning Objective: 01-02 Identify assurance services that involve attestation. Topic: Attest Function* |

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| 37. | Which of the following best describes the reason why independent auditors report on financial statements?      |  |  | | --- | --- | | A. | A management fraud may exist and it is more likely to be detected by independent auditors. |  |  |  | | --- | --- | | **B.** | Different interests may exist between the company preparing the statements and the persons using the statements. |  |  |  | | --- | --- | | C. | A misstatement of account balances may exist and is generally corrected as the result of the independent auditors' work. |  |  |  | | --- | --- | | D. | Poorly designed internal control may be in existence. | |

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| *AACSB: Analytic AICPA BB: Industry AICPA FN: Decision Making Blooms: Remember Difficulty: 2 Medium Source: AICPA Topic: Financial Statement Audits* |

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| 38. | Governmental auditing often extends beyond examinations leading to the expression of opinion on the fairness of financial presentation and includes audits of efficiency, economy, effectiveness, and also:      |  |  | | --- | --- | | A. | Accuracy. |  |  |  | | --- | --- | | B. | Evaluation. |  |  |  | | --- | --- | | **C.** | Compliance. |  |  |  | | --- | --- | | D. | Internal control. | |

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| *AACSB: Reflective Thinking AICPA BB: Critical Thinking AICPA FN: Decision Making Blooms: Understand Difficulty: 3 Hard Learning Objective: 01-06 Contrast the various types of audits and types of auditors. Source: AICPA Topic: Financial Statement Audits* |

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| 39. | Operational auditing is primarily oriented toward:      |  |  | | --- | --- | | **A.** | Future improvements to accomplish the goals of management. |  |  |  | | --- | --- | | B. | The accuracy of data reflected in management's financial records. |  |  |  | | --- | --- | | C. | The verification that a company's financial statements are fairly presented. |  |  |  | | --- | --- | | D. | Past protection provided by existing internal control. | |

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| *AACSB: Reflective Thinking AICPA BB: Critical Thinking AICPA FN: Decision Making Blooms: Understand Difficulty: 3 Hard Learning Objective: 01-06 Contrast the various types of audits and types of auditors. Source: AICPA Topic: Financial Statement Audits* |

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| 40. | A typical objective of an operational audit is for the auditor to:      |  |  | | --- | --- | | A. | Determine whether the financial statements fairly present the entity's operations. |  |  |  | | --- | --- | | B. | Evaluate the feasibility of attaining the entity's operational objectives. |  |  |  | | --- | --- | | **C.** | Make recommendations for improving performance. |  |  |  | | --- | --- | | D. | Report on the entity's relative success in attaining profit maximization. | |

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| *AACSB: Reflective Thinking AICPA BB: Critical Thinking AICPA FN: Decision Making Blooms: Understand Difficulty: 3 Hard Learning Objective: 01-06 Contrast the various types of audits and types of auditors. Source: AICPA Topic: Financial Statement Audits* |

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| 41. | An integrated audit performed under the Sarbanes-Oxley Act requires that auditors report on:          |  |  | | --- | --- | | **A.** | Option A |  |  |  | | --- | --- | | B. | Option B |  |  |  | | --- | --- | | C. | Option C |  |  |  | | --- | --- | | D. | Option D | |

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| *AACSB: Analytic AICPA BB: Industry AICPA FN: Decision Making Blooms: Remember Difficulty: 2 Medium Learning Objective: 01-06 Contrast the various types of audits and types of auditors. Topic: Financial Statement Audits* |

**Matching Questions**

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| 42. | Accountants are regulated by a variety of organizations. Match the following statements with the most directly related organizations. Organizations may be used once or not at all.      |  |  |  | | --- | --- | --- | | 1. Formed to improve standards of financial accounting for state and local government entities | State Boards of Accountancy. | **2** | | 2. Issue CPA certificates | Government Accounting Standards Board. | **1** | | 3. Develop accounting standards for public and nonpublic companies | American Institute of Certified Public Accountants. | **6** | | 4. Develop accounting standards for the U.S. Government | Financial Accounting Standards Board. | **3** | | 5. Issue auditing standards for public companies | Federal Accounting Standards Advisory Board. | **4** | | 6. Prepares the CPA exam | Public Company Accounting Oversight Board. | **5** | |

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| *AACSB: Analytic AICPA BB: Industry AICPA FN: Decision Making Blooms: Remember Difficulty: 2 Medium Learning Objective: 01-06 Contrast the various types of audits and types of auditors. Learning Objective: 01-07 Explain the regulatory process for auditors of public companies and auditors of nonpublic companies. Topic: Financial Statement Audits Topic: Public Accounting Profession* |

**Essay Questions**

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| 43. | The Sarbanes-Oxley Act of 2002 made significant reforms for public companies and their auditors.  a. Describe the events that led up to the passage of the Act. b. Describe the major changes made by the Act.     a. The events leading up to the passage of the Sarbanes-Oxley Act include:  • A large number of misstatements of financial statements, many of which resulted from fraudulent financial reporting. Notably including WorldCom and Enron. • The conviction of the Big 5 accounting firm of Arthur Andersen on charges of destroying evidence.  b. The major reforms made the Act include:  • Tougher penalties for fraud. • Restrictions on the types of consulting services that may be provided by auditors to their public audit clients. • The creation of the Public Company Accounting Oversight Board to create auditing standards and oversee accounting firms that audit public companies. • Requirements for management to make an assertion about the effectiveness of internal control. • Requirements for auditors of public companies to audit and report on internal control. |

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| *AACSB: Reflective Thinking AICPA BB: Critical Thinking AICPA FN: Decision Making Blooms: Understand Difficulty: 3 Hard Learning Objective: 01-05 Describe how the credibility of the accounting profession was affected by the large number of companies reporting accounting irregularities in the beginning of this century. Learning Objective: 01-06 Contrast the various types of audits and types of auditors. Topic: Financial Statement Audits* |

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| 44. | Many people confuse the responsibilities of the independent auditors and the client's management with respect to audited financial statements.  a. Describe management's responsibility regarding audited financial statements. b. Describe the independent auditors' responsibility regarding audited financial statements. c. Evaluate the following statement: "If the auditors disagree with management regarding an accounting principle used in the financial statements the auditors should express their views in the notes to the financial statements."     a. Management has primary responsibility for the fairness of the financial statements and internal control. b. The auditors are responsible for performing an independent audit of the financial statements and issuing a report on them in accordance with generally accepted auditing standards. c. The statement if false. The notes to the financial statements should contain only representations of management. The auditors should express their reservations in their report. |

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| *AACSB: Analytic AICPA BB: Industry AICPA FN: Decision Making Blooms: Remember Difficulty: 2 Medium Learning Objective: 01-02 Identify assurance services that involve attestation. Topic: Attest Function* |

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| 45. | An investor is considering investing in one of two companies. The companies have very similar reported financial position and results of operations. However, only one of the companies has its financial statements audited.  a. Describe what creates the demand for an audit in this situation. Include a discussion of how audited financial statements facilitate this investment transaction, and the effect of the audit on business risk and information risk. b. Identify the potential consequences to the company of not having its financial statements audited.     a. Audits add credibility to the financial statements of the company. The individual can invest in the company knowing that there is a low probability that the financial statements depart materially from generally accepted accounting principles. Audited financial statements facilitate this transaction by reducing risk related to the investment. Specifically, audits reduce information risk--the risk that information used to make the investment decision is misstated--related to the financial statements. Audited financial statements do not directly affect business risk, which is the risk that the company will not be able to meet its financial obligations.  b. The potential consequences of not having an audit are:  • If the investor is particularly risk averse, he or she may not invest in the company at all. • If the investor decides to invest in the company, he or she will not be willing to pay as high a price because the investor will want to be compensated for the additional risk that is involved in relying upon unaudited financial statements. |

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| *AACSB: Analytic AICPA BB: Industry AICPA FN: Decision Making Blooms: Remember Difficulty: 2 Medium Learning Objective: 01-04 Explain why audits are demanded by society. Topic: Financial Statement Audits* |