

Auditing and Assurance Services, 14e (Arens)
Chapter 2 The CPA Profession

Learning Objective 2-1

1) The legal right to perform audits is granted to a CPA firm by regulation of:

- A) each state.
- B) the Financial Accounting Standards Board (FASB).
- C) the American Institute of Certified Public Accountants (AICPA).
- D) the Audit Standards Board.

Answer: A

Terms: Legal rights to perform audits

Diff: Moderate

Objective: LO 2-1

AACSB: Reflective thinking skills

2) The four categories for describing the size of audit firms include: the Big Four international firms; national firms; regional and local firms; and small firms. Which of the following is not a characteristic of a small firm?

- A) Most have fewer than 25 professionals.
- B) They perform audits on small and not-for-profit businesses.
- C) Tax services are more important to their practice than auditing.
- D) They do not audit publically traded companies.

Answer: D

Terms: Four categories for describing size of audit firms

Diff: Moderate

Objective: LO 2-1

AACSB: Reflective thinking skills

3) Sarbanes-Oxley and the Securities Exchange Commission restrict auditors from providing many consulting services to their publically traded audit clients. Which of the following is true for auditors of publically traded companies?

- I. They are restricted from providing consulting services to privately held companies.
- II. There is no restriction on providing consulting services to non-audit clients.

- A) I only
- B) II only
- C) I and II
- D) Neither I or II

Answer: B

Terms: Sarbanes-Oxley and Securities Exchange Commission restrictions

Diff: Moderate

Objective: LO 2-1

AACSB: Reflective thinking skills

Topic: SOX

4) Which of the following statements is true as it relates to limited liability partnerships?

- A) Only senior partners are liable for the partnership's debts.
- B) Partners have no liability in a limited liability partnership arrangement.
- C) Partners are personally liable for the acts of those under their supervision.
- D) All partners must be AICPA members.

Answer: C

Terms: Limited liability partnerships

Diff: Challenging

Objective: LO 2-1

AACSB: Reflective thinking skills

5) List and describe the three factors that influence the organizational structure of all CPA firms. What are the most common forms of CPA firm organization?

Answer: The three factors that influence the organization of a CPA firm include:

1. Independence from clients. Independence is important as it allows the auditors to remain unbiased in drawing conclusions on client financial statements.
2. Auditor Competency. Competency allows auditors to conduct audits and perform services effectively and efficiently.
3. Litigation. The increased litigation risk faced by auditors increases audit firm business risk. Certain organizational structures allow a degree of personal protection to individual firm members.

Common forms of audit firm organization include:

- Limited Liability Partnerships
- Limited Liability Companies
- Professional Corporations
- General Corporations
- General Partnerships
- Sole Proprietorship

Terms: Factors that influence that influence the organizational structure of CPA firms

Diff: Moderate

Objective: LO 2-1

AACSB: Reflective thinking skills

6) List and describe the six organizational structures available to CPA firms.

Answer: CPA firms can take one of six organizational forms:

- *Proprietorship*. This form is limited to firms with only one owner.
- *General partnership*. This form is similar to a proprietorship, except that it applies to multiple owners.
- *General corporation*. Unlike a general partnership, shareholders in a general corporation are liable only to the extent of their investment in the corporation.
- *Professional corporation*. Professional corporations can have one or more shareholders. Personal liability protection for shareholders in professional corporations varies widely from state to state.
- *Limited liability company*. This form combines the most favorable attributes of a general corporation and a general partnership. LLCs are taxed like a general partnership, but its owners have limited personal liability like shareholders of a general corporation.
- *Limited liability partnership*. An LLP is structured and taxed like a general partnership. However, the personal liability protection of an LLP is less than that of a general corporation or an LLC, but it is greater than a general partnership. Many accounting firms now operate as LLPs.

Terms: Organizational structures available to CPA firms

Diff: Moderate

Objective: LO 2-1

AACSB: Reflective thinking skills

7) Many small/local accounting firms do not perform audits as their primary services to their clients include accounting and tax.

A) True

B) False

Answer: A

Terms: Small accounting firms do not perform audits

Diff: Easy

Objective: LO 2-1

AACSB: Reflective thinking skills

8) All of the Big Four and many of the smaller CPA firms now operate as Limited Liability Partnerships.

A) True

B) False

Answer: A

Terms: Limited liability partnerships

Diff: Easy

Objective: LO 2-1

AACSB: Reflective thinking skills

9) Sarbanes-Oxley and the Securities Exchange Commission restrict auditors from providing many consulting services to their publically traded audit clients.

A) True

B) False

Answer: B

Terms: Sarbanes-Oxley and Securities Exchange Commission restrict auditors

Diff: Easy

Objective: LO 2-1

AACSB: Reflective thinking skills

Topic: SOX

10) Limited liability companies are structured and taxed like a general partnership, but their owners have limited personal liability similar to that of a general corporation.

A) True

B) False

Answer: A

Terms: Limited liability companies

Diff: Moderate

Objective: LO 2-1

AACSB: Reflective thinking skills

Learning Objective 2-2

1) The organization that is responsible for providing oversight for auditors of public companies is called the _____.

A) Auditing Standards Board.

B) American Institute of Certified Public Accountants.

C) Public Oversight Board.

D) Public Company Accounting Oversight Board.

Answer: D

Terms: Organization responsible for providing oversight for auditors of public companies

Diff: Easy

Objective: LO 2-2

AACSB: Reflective thinking skills

Topic: SOX

2) Members of the Public Company Accounting Oversight Board are appointed and overseen by:

A) the U.S. Congress.

B) the American Institute of Certified Public Accountants.

C) the Auditing Standards Board.

D) the Securities and Exchange Commission.

Answer: D

Terms: Members of Public Company Accounting Oversight Board

Diff: Easy

Objective: LO 2-2

AACSB: Reflective thinking skills

Topic: SOX

3) The Public Company Accounting Oversight Board:

A) perform inspections of the quality controls at audit firms that audit public companies.

B) establish auditing standards that must be followed by CPAs on all audits.

C) oversee auditors of private companies.

D) perform any of the above functions.

Answer: A

Terms: Public Company Accounting Oversight Board

Diff: Moderate

Objective: LO 2-2

AACSB: Reflective thinking skills

Topic: SOX

4) Assume the Public Company Accounting Oversight Board (PCAOB) identifies a violation during its inspection of a registered accounting firm. The PCAOB:

A)

| | | |
|---|---|--|
| can enforce disciplinary action against the accounting firm | report the matter to the Securities and Exchange Commission | suspend the license to practice of the CPA guilty of the violation |
| Yes | Yes | Yes |

B)

| | | |
|---|---|--|
| can enforce disciplinary action against the accounting firm | report the matter to the Securities and Exchange Commission | suspend the license to practice of the CPA guilty of the violation |
| Yes | Yes | No |

C)

| | | |
|---|---|--|
| can enforce disciplinary action against the accounting firm | report the matter to the Securities and Exchange Commission | suspend the license to practice of the CPA guilty of the violation |
| Yes | No | No |

D)

| | | |
|---|---|--|
| can enforce disciplinary action against the accounting firm | report the matter to the Securities and Exchange Commission | suspend the license to practice of the CPA guilty of the violation |
| No | No | No |

Answer: B

Terms: Public Company Accounting Oversight Board inspection violations

Diff: Moderate

Objective: LO 2-2

AACSB: Reflective thinking skills

Topic: SOX

5) The Sarbanes-Oxley Act established the Public Company Accounting Oversight Board (PCAOB). What are the PCAOB's primary functions? Who performed these functions prior to the PCAOB?

Answer: The PCAOB has responsibility for providing oversight to auditors of public companies, establishing auditing and quality control standards for public company audits and performing inspections of the quality controls at audit firms performing those audits. These functions were formerly the responsibility of the American Institute of Certified Public Accountants.

Terms: Sarbanes-Oxley Act; Public Company Accounting Oversight Board primary functions

Diff: Moderate

Objective: LO 2-2

AACSB: Reflective thinking skills

Topic: SOX

6) The Public Company Accounting Oversight Board (PCAOB) provides oversight to auditors of publically traded and private companies.

A) True

B) False

Answer: B

Terms: Public Company Accounting Oversight Board

Diff: Easy

Objective: LO 2-2

AACSB: Reflective thinking skills

7) All CPA firms registered with the PCAOB are required to undergo a peer review annually.

A) True

B) False

Answer: B

Terms: PCAOB requirement for peer review

Diff: Moderate

Objective: LO 2-2

AACSB: Reflective thinking skills

Topic: SOX

Learning Objective 2-3

1) The form that must be completed and filed with the Securities and Exchange Commission whenever a company experiences a significant event that is of interest to public investors is the:

A) Form S-1.

B) Form 8-K.

C) Form 10-K.

D) Form 10-Q.

Answer: B

Terms: Sec form 8-k, reporting significant events

Diff: Moderate

Objective: LO 2-3

AACSB: Reflective thinking skills

2) The form that must be filed with the Securities and Exchange Commission whenever a company plans to issue new securities to the public is the:

A) Form S-1.

B) Form 8-K.

C) Form 10-K.

D) Form 10-Q.

Answer: A

Terms: Form must be completed and filed with Securities and Exchange Commission when company plans to issue new securities

Diff: Moderate

Objective: LO 2-3

AACSB: Reflective thinking skills

3) The AICPA has authority to establish standards and rules in all but which of the following areas?

- A) Auditing standards applicable to financial statements of private companies
- B) Compilation and review standards
- C) Professional conduct
- D) Auditing standards applicable to financial statements of private and public companies

Answer: D

Terms: AICPA has authority to establish standards and rules

Diff: Challenging

Objective: LO 2-3

AACSB: Reflective thinking skills

4) Discuss the purpose of the Securities and Exchange Commission and its influence on setting generally accepted accounting principles.

Answer: The overall purpose of the SEC is to assist in providing investors with reliable information upon which to make investment decisions. As a result of its authority for specifying financial reporting requirements, the SEC has considerable influence in setting generally accepted accounting principles.

Although the SEC has taken the position that accounting principles should be set by the profession (FASB), the SEC's opinion is generally considered in any major change in GAAP proposed by the FASB.

Terms: Securities and Exchange Commission influence on setting generally accepted accounting principles

Diff: Moderate

Objective: LO 2-3

AACSB: Reflective thinking skills

5) The difference between the Securities Act of 1933 and the Securities Act of 1934 is that only the 1934 act requires audited financial statements.

- A) True
- B) False

Answer: B

Terms: Securities Acts of 1933 and 1934

Diff: Easy

Objective: LO 2-3

AACSB: Reflective thinking skills

6) Form 10-K must be filed with the SEC whenever a public company experiences a significant event.

- A) True
- B) False

Answer: B

Terms: Form 10-K; SEC

Diff: Moderate

Objective: LO 2-3

AACSB: Reflective thinking skills

7) The overall purpose of the Securities and Exchange Commission is to assist in providing investors with reliable information upon which to make investment decisions.

- A) True
- B) False

Answer: A

Terms: Securities and Exchange Commission

Diff: Moderate

Objective: LO 2-3

AACSB: Reflective thinking skills

Learning Objective 2-4

1) Statements on Standards for Accounting and Review Services are issued by the:

- A) Accounting and Review Services Committee.
- B) Professional Ethics Executive Committee.
- C) Securities and Exchange Commission.
- D) Financial Accounting Standards Board.

Answer: A

Terms: Statements on Standards for Accounting and Review Services (SSARS)

Diff: Moderate

Objective: LO 2-4

AACSB: Reflective thinking skills

2) Which of the following is not an essential component of quality control?

- A) Policies and procedures to ensure that firm personnel are actively engaged in marketing strategies.
- B) Policies and procedures to ensure that the work performed by firm personnel meet applicable professional standards.
- C) Policies to ensure that personnel maintain their independence in fact and in appearance.
- D) Policies that ensure that monitoring activities are effectively applied.

Answer: A

Terms: Component of quality control

Diff: Moderate

Objective: LO 2-4

AACSB: Reflective thinking skills

3) What are the major functions of the AICPA?

Answer: Major functions of the AICPA include:

- Establishing standards and rules that practicing CPAs must follow. These standards consist of auditing standards for auditors of private companies, compilation and review standards, other attestation standards, and the *Code of Professional Conduct*.
- Research and publication on many different subjects related to accounting, auditing, attestation and assurance services, management consulting services, and taxes. AICPA publications include the *Journal of Accountancy*, industry audit guides, periodic updates of the *Codification of Statements on Auditing Standards*, and the *Code of Professional Conduct*.
- Promoting the accounting profession through organizing national advertising campaigns.
- Developing specialist certifications to help market and ensure the quality of services in specialized practice areas.
- Writing and grading the uniform CPA examination.
- Providing continuing education seminars for its members.

Terms: Major functions of AICPA

Diff: Moderate

Objective: LO 2-4

AACSB: Reflective thinking skills

4) Membership in the AICPA is restricted to CPAs who are currently practicing as independent auditors.

A) True

B) False

Answer: B

Terms: Membership in AICPA

Diff: Easy

Objective: LO 2-4

AACSB: Reflective thinking skills

5) Membership in the AICPA is mandatory for all licensed practicing CPAs.

A) True

B) False

Answer: B

Terms: Membership in AICPA

Diff: Easy

Objective: LO 2-4

AACSB: Reflective thinking skills

6) Any public accounting firm can be a member of the AICPA if the firm meets the membership requirements.

A) True

B) False

Answer: A

Terms: Membership in AICPA

Diff: Easy

Objective: LO 2-4

AACSB: Reflective thinking skills

Learning Objective 2-5

1) Which of the following are audit standards used in professional practice by audit firms?

A)

| International Standards on Auditing | U.S. Generally Accepted Auditing Standards | PCAOB Auditing Standards |
|-------------------------------------|--|--------------------------|
| Yes | No | No |

B)

| International Standards on Auditing | U.S. Generally Accepted Auditing Standards | PCAOB Auditing Standards |
|-------------------------------------|--|--------------------------|
| Yes | Yes | No |

C)

| International Standards on Auditing | U.S. Generally Accepted Auditing Standards | PCAOB Auditing Standards |
|-------------------------------------|--|--------------------------|
| Yes | Yes | Yes |

D)

| International Standards on Auditing | U.S. Generally Accepted Auditing Standards | PCAOB Auditing Standards |
|-------------------------------------|--|--------------------------|
| No | Yes | Yes |

Answer: C

Terms: Standards used in professional practice

Diff: Easy

Objective: LO 2-5

AACSB: Reflective thinking skills

2) For privately held companies who of the following is responsible for establishing auditing standards?

A) Securities and Exchange Commission

B) Public Company Accounting Oversight Board

C) Auditing Standards Board

D) National Association of Accounting

Answer: C

Terms: Establishing auditing standards for privately held companies

Diff: Easy

Objective: LO 2-5

AACSB: Reflective thinking skills

3) Standards issued by the Public Company Accounting Oversight Board must be followed by CPAs who audit:

- A) both private and public companies.
- B) public companies only.
- C) private companies, public companies, and nonprofit entities.
- D) private companies only.

Answer: B

Terms: Public Company Accounting Oversight Board Standards

Diff: Moderate

Objective: LO 2-5

AACSB: Reflective thinking skills

Topic: SOX

4) The Audit Standards Board of the AICPA has undertaken the Clarity & Convergence Project to make GAAS easier to read understand and apply; as well as converge GAAS with the International Standards on Auditing (ISAs). Which of the following statements concerning the Clarity & Convergence Project is(are) true?

- I. The "General" standards of GAAS will be termed "Responsibilities".
- II. The "Fieldwork" standards will be termed "Performance".
- III. The "Reporting" standards will be termed "Communications".

- A) I and II
- B) I and III
- C) II and III
- D) I, II and III

Answer: D

Terms: Clarity and Convergence Project

Diff: Moderate

Objective: LO 2-5

AACSB: Reflective thinking skills

5) If an auditor of a public company cannot find guidance issued by the PCAOB on a particular audit matter, the auditor should generally seek guidance from which of the following sources?

- A) Statements on Auditing Standards
- B) Statements on Standards for Accounting and Review Services
- C) Regulations issued by the Securities and Exchange Commission
- D) The AICPA *Code of Professional Conduct*

Answer: A

Terms: Guidance issued by PCAOB

Diff: Challenging

Objective: LO 2-5

AACSB: Reflective thinking skills

Topic: SOX

6) The Auditing Standards Board of the AICPA has undertaken a Clarity and Convergence Project whose aim is to make GAAS easier to read, apply and converge with International Audit Standards. As a result the GAAS will become "Auditing Principles". The principles will be consistent with the three categories of GAAS. Accordingly, which of the following is true?

- I The General Standards will be termed Responsibilities Principles.
 - II. The Fieldwork Standards will be termed Performance Principles.
 - III. The Reporting Standards will be termed Communication Principles.
- A) I and II
 - B) I and III
 - C) II and III
 - D) I, II and III

Answer: A

Terms: Clarity and Convergence Project

Diff: Challenging

Objective: LO 2-5

AACSB: Reflective thinking skills

7) Auditors of public companies should, in the absence of guidance issued by the PCAOB, follow auditing standards issued by the SEC.

- A) True
- B) False

Answer: B

Terms: Auditors of public companies; PCAOB and SEC

Diff: Easy

Objective: LO 2-5

AACSB: Reflective thinking skills

Topic: SOX

8) International Standards on Auditing are issued by the International Auditing Practices Committee.

- A) True
- B) False

Answer: A

Terms: International Standards on Auditing; International Auditing Practices Committee

Diff: Moderate

Objective: LO 2-5

AACSB: Reflective thinking skills

Learning Objective 2-6

1) Which one of the following is not one of the three General Standards?

- A) Proper planning and supervision.
- B) Independence of mental attitude.
- C) Adequate training and proficiency.
- D) Due professional care.

Answer: A

Terms: General standards

Diff: Easy

Objective: LO 2-6

AACSB: Reflective thinking skills

2) Which one of the following is not a Field Work Standard?

- A) Adequate planning and supervision.
- B) Due professional care.
- C) Understand the entity and its environment including internal control.
- D) Sufficient appropriate audit evidence.

Answer: B

Terms: Field Work Standards

Diff: Easy

Objective: LO 2-6

AACSB: Reflective thinking skills

3) The generally accepted auditing standard that requires "Adequate technical training and proficiency" is normally interpreted as requiring the auditor to have:

- A) formal education in auditing and accounting.
- B) worked for an entity similar to the entity being audited.
- C) independence in mental attitude.
- D) a graduate degree in a business field.

Answer: A

Terms: General accepted auditing standards; Adequate technical training and proficiency

Diff: Easy

Objective: LO 2-6

AACSB: Reflective thinking skills

4) Which of the following statements most accurately captures the intent of the standards of field work?

- A) Field work standards are primarily concerned with personal attributes necessary during the conduct of the audit.
- B) Field work standards provide extensive guidance regarding the conduct of an audit.
- C) Field work standards are primarily directed at the auditor's planning, understanding of internal control, and evidence accumulation.
- D) Field work standards are primarily concerned with the conduct of substantive testing as opposed to testing of internal controls.

Answer: C

Terms: Standards of field work

Diff: Easy

Objective: LO 2-6

AACSB: Reflective thinking skills

5) The Statements on Auditing Standards issued by the Auditing Standards Board:

- A) interpret generally accepted auditing standards.
- B) are the equivalent of laws for audit practitioners.
- C) must be followed in all situations.
- D) are optional guidelines which an auditor may choose to follow or not follow when conducting an audit.

Answer: A

Terms: Statements on Auditing Standards

Diff: Moderate

Objective: LO 2-6

AACSB: Reflective thinking skills

6) An auditor need not abide by a particular auditing standard if the auditor believes that:

- A) the issue in question is immaterial in amount.
- B) more expertise is needed to fulfill the requirement.
- C) the requirement of the standard has not been addressed by the PCAOB.
- D) any of the above three are correct.

Answer: A

Terms: Auditor need not abide by a particular auditing standard

Diff: Moderate

Objective: LO 2-6

AACSB: Reflective thinking skills

7) Under GAAS, which of the following reflects a concept from the *general* group?

- A) The confirmation of accounts receivable.
- B) Completing an internal control questionnaire.
- C) The initial planning of the audit with the audit partner, manager, senior, staff and client personnel.
- D) The assignment of audit personnel to an engagement where they have no financial interest.

Answer: D

Terms: GAAS, general standards

Diff: Moderate

Objective: LO 2-6

AACSB: Reflective thinking skills

8) The third general standard states that due care is to be exercised in the performance of an audit. This standard is generally interpreted to require:

- A) objective review of the adequacy of the technical training of firm personnel.
- B) thorough review of the existing internal control structure.
- C) critical review of work done at every level of supervision.
- D) periodic review of a CPA firm's quality control procedures.

Answer: C

Terms: Third general standard; Due care

Diff: Moderate

Objective: LO 2-6

AACSB: Reflective thinking skills

9) Which of the following statements best describes the primary purpose of Statements on Auditing Standards?

- A) They are guides intended to set forth auditing procedures that are applicable to a variety of situations.
- B) They are procedural outlines that are intended to narrow the areas of inconsistency and divergence of auditor opinion.
- C) They are authoritative statements, enforced through the Code of Professional Conduct, and are intended to limit the degree of auditor judgment.
- D) They are interpretations that are intended to clarify the meaning of "generally accepted auditing standards."

Answer: D

Terms: Purpose of Statements on Auditing Standards

Diff: Moderate

Objective: LO 2-6

AACSB: Reflective thinking skills

10) Hansen Corporation's stock is listed on a national stock exchange and registered with the Securities and Exchange Commission. Hansen's management hires a CPA to perform an independent audit of Hansen's financial statements. The primary objective of this audit is to provide assurance to the:

- A) investors in Hansen Corporation's stock.
- B) stock exchange.
- C) Securities and Exchange Commission.
- D) management of Hansen Corporation.

Answer: A

Terms: Primary objective of audit to provide assurance

Diff: Moderate

Objective: LO 2-6

AACSB: Reflective thinking skills

11) Which of the following statements about Generally Accepted Audit Standards are true?

- I. They serve as broad guidelines to auditors for conducting an audit engagement.
 - II. They are sufficiently specific to provide any meaningful guide to practitioners.
 - III. They represent a framework upon which the AICPA can provide interpretations..
- A) I and II
 - B) I and III
 - C) II and III
 - D) I, II and III

Answer: B

Terms: Generally Accepted Audit Standards

Diff: Challenging

Objective: LO 2-6

AACSB: Reflective thinking skills

12) Generally Accepted Auditing Standards (GAAS) and Statements on Auditing Standards (SAS) should be looked upon by practitioners as:

- A) ideals to work towards, but which are not achievable.
- B) maximum standards that denote excellent work.
- C) minimum standards of performance that must be achieved on each audit engagement.
- D) benchmarks to be used on all audits, reviews, and compilations.

Answer: C

Terms: Generally Accepted Auditing Standards (GAAS) and Statements on Auditing Standards (SAS)

Diff: Challenging

Objective: LO 2-6

AACSB: Reflective thinking skills

13) Statements on Auditing Standards issued by the AICPA's Auditing Standards Board are:

- A) part of the generally accepted auditing standards under the AICPA *Code of Professional Conduct*.
- B) interpretations of generally accepted auditing standards and departures from such statements must be justified.
- C) interpretations of generally accepted auditing standards and such standards must be followed in every engagement.
- D) generally accepted auditing procedures that are not covered by the AICPA *Code of Professional Conduct*.

Answer: B

Terms: Statements on Auditing Standards

Diff: Challenging

Objective: LO 2-6

AACSB: Reflective thinking skills

14) List the ten generally accepted auditing standards and divide them into their proper category.

Answer:

General Standards

- Adequate technical training and proficiency.
- Independence in mental attitude.
- Due professional care.

Standards of Fieldwork

- Adequate planning and supervision.
- Understand the entity and its environment including internal control.
- Sufficient appropriate audit evidence.

Standards of Reporting

- Whether statements were prepared in accordance with GAAP.
- Circumstances when GAAP was not consistently followed.
- Adequacy of informative disclosures.
- Expression of opinion on financial statements as a whole.

Terms: Generally Accepted Auditing Standards

Diff: Moderate

Objective: LO 2-6

AACSB: Reflective thinking skills

15) Distinguish between generally accepted auditing standards (GAAS) and generally accepted accounting principles (GAAP). What professional organization establishes GAAS? What professional organization establishes GAAP?

Answer: Generally accepted auditing standards are general guidelines to help auditors meet their professional responsibilities in the audit of historical financial statements. The general standards stress the important personal qualities that the auditor should possess. The standards of field work concern evidence accumulation and other activities during the actual conduct of the audit. The reporting standards require the auditor to prepare a report on the financial statements taken as a whole, stating whether the statements are prepared in accordance with Generally Accepted Accounting Principles (GAAP). They are considered to be the minimum standards of performance for auditors to follow and are established by the Auditing Standards Board of the American Institute of Certified Public Accountants for private companies and by the Public Company Accounting Oversight Board for public companies. Generally accepted accounting principles are the guidelines which an entity's management normally follows when preparing historical financial statements. GAAP is established by the Financial Accounting Standards Board.

Terms: Generally Accepted Auditing Standards

Diff: Easy

Objective: LO 2-5 and LO 2-6

AACSB: Reflective thinking skills

16) Statements on Auditing Standards are considered authoritative literature.

A) True

B) False

Answer: A

Terms: Statements on Auditing Standards

Diff: Easy

Objective: LO 2-6

AACSB: Reflective thinking skills

17) Statements on Auditing Standards (SASs) are issued by the Public Company Accounting Oversight Board.

A) True

B) False

Answer: B

Terms: Statements on Auditing Standards (SAS); Public Company Accounting Oversight Board

Diff: Easy

Objective: LO 2-6

AACSB: Reflective thinking skills

18) Statements on Auditing Standards (SASs) are considered to be interpretations of the ten generally accepted auditing standards.

A) True

B) False

Answer: A

Terms: Statements on Auditing Standards (SAS); Generally accepted auditing standards

Diff: Moderate

Objective: LO 2-6

AACSB: Reflective thinking skills

Learning Objective 2-7

- 1) Which of the following is not true for audit firms who audit publically traded companies?
- A) They must undergo a PCAOB inspection on an annual basis if they audit more than 100 issuers
 - B) They must have an AICPA peer review on all audit clients.
 - C) They must have an AICPA peer review on all non-publically traded clients.
 - D) The audit firm can choose which CPA firm they wish to conduct their AICPA peer review.

Answer: B

Terms: Audit firms who audit publically traded companies

Diff: Moderate

Objective: LO 2-7

AACSB: Reflective thinking skills

- 2) A basic objective of a CPA firm is to provide professional services to conform to professional standards. Reasonable assurance of achieving this basic objective is provided through:

- A) continuing professional education.
- B) compliance with generally accepted reporting standards.
- C) a system of quality control.
- D) a system of peer review.

Answer: C

Terms: Professional standards

Diff: Moderate

Objective: LO 2-7

AACSB: Reflective thinking skills

- 3) Within the context of quality control, the primary purpose of continuing professional education and training activities is to enable a CPA firm to provide its personnel with:

- A) technical training that assures proficiency as a valuation expert.
- B) professional education that is required in order to perform with due professional care.
- C) knowledge required to fulfill assigned responsibilities.
- D) knowledge required to perform a peer review.

Answer: C

Terms: Quality control; Continuing professional education and training activities

Diff: Moderate

Objective: LO 2-7

AACSB: Reflective thinking skills

- 4) The purpose of establishing quality control policies and procedures to accept or continue a client relationship is to:

- A) provide reasonable assurance that personnel are adequately trained to fulfill their responsibilities.
- B) monitor the risk factors concerning misstatements that arise from the misappropriation of assets.
- C) document objective criteria for the CPA firm's peer review.
- D) minimize the likelihood of associating with client's whose management may lack integrity.

Answer: D

Terms: Purpose of quality control policies and procedures to accept or continue client relationship

Diff: Moderate

Objective: LO 2-7

AACSB: Reflective thinking skills

5) Which of the following is an element of the CPA's quality control system that should be considered in establishing its quality control policies and procedures?

- A) Considering audit risk and materiality.
- B) Using statistical sampling techniques.
- C) Assigning personnel to engagements.
- D) Complying with laws and regulations.

Answer: C

Terms: Quality control policies and procedures

Diff: Moderate

Objective: LO 2-7

AACSB: Reflective thinking skills

6) Which one of the following is not true regarding the American Institute of Certified Public Accountants peer review requirement?

- A) A CPA firm must develop and adhere to quality control standards.
- B) Peer reviews are mandatory.
- C) A CPA firm will lose AICPA eligibility if a peer review is not performed.
- D) Firms required to be registered with and inspected by the PCAOB are exempt.

Answer: D

Terms: AICPA peer review

Diff: Challenging

Objective: LO 2-7

AACSB: Reflective thinking skills

7) Discuss the relationship between quality control and generally accepted auditing standards.

Answer: For a CPA firm, quality control encompasses the methods used to make sure that the firm meets its professional responsibilities to clients. Quality control is closely related to, but distinct from, GAAS.

The standards recognize that a quality control system can provide only reasonable assurance, not a guarantee that auditing standards are followed. A CPA firm must make sure that GAAS are followed on every audit. Quality controls are the procedures used by the entire CPA firm that help it meet requirements demanded by GAAS on every engagement in a consistent manner.

Terms: Relationship between quality control and generally accepted auditing standards

Diff: Easy

Objective: LO 2-7

AACSB: Reflective thinking skills

8) List and describe the six elements of quality control. Who establishes the standards for quality control?

Answer:

- *Leadership responsibilities for quality within the firm* - Firm should promote that quality is essential in performing engagements and should establish policies and procedures that support that culture.
- *Relevant ethical requirements* - Personnel on engagement should maintain independence in fact and in appearance, perform all professional responsibilities with integrity and maintain objectivity in performing their professional responsibilities.
- *Human Resources* - Policies and procedures should be established to provide the firm with reasonable assurance that all new personnel are qualified to perform their work, work is assigned to personnel who have adequate training, and personnel should participate in continuing professional education.
- *Acceptance and continuation of clients and engagements* - Policies and procedures should be established for deciding whether to accept or continue a client relationship. These policies should minimize the risk of associating with a client whose management lacks integrity.
- *Engagement performance* - Policies and procedures should exist to ensure that engagement personnel perform work that meets applicable professional standards and the firm's standards of quality.
- *Monitoring* - Policies and procedures should exist to ensure that the other four quality control elements are being effectively applied.

Quality control standards are established by the Auditing Standards Board for auditors of private companies and by the Public Company Accounting Oversight Board for auditors of public companies.

Terms: Elements of quality controls

Diff: Moderate

Objective: LO 2-7

AACSB: Reflective thinking skills

9) Listed below are policies or procedures that the Crystal Cove audit firm has in place. For each identified policy or procedure state if it is a Generally Accepted Audit Standard (GAAS) or a Quality Control Standard.

| <u>Audit firm Policy or Procedure</u> | <u>Standards Category</u> |
|--|---|
| 1. Independence in mental attitude. 2. A client evaluation form. 3. All personnel participate in continuing professional education. 4. Conducting the audit with professional skepticism. 5. Answering an independence questionnaire. 6. Understand the client industry. 7. Audit staff workpapers are reviewed by audit seniors, then managers. 8. Audit staff are supervised. | a. GAAP Standards b. Quality Control Standards |

Answer:

1. a
2. b
3. b
4. a
5. b
6. a
7. b
8. a

Terms: Generally Accepted Audit Standards (GAAS) and Quality Control Standards

Diff: Moderate

Objective: LO 2-6 and LO 2-7

AACSB: Reflective thinking skills

10) The following are definitions of terms that are listed on the right. Match the definition with its associated term. Each term can be used once, more than once or not at all.

| <u>Definition</u> | <u>Audit Term</u> |
|---|-----------------------------------|
| 1. An organizational structure where professional services are provided by one or more shareholders. | a. AICPA |
| 2. The grantor of the right to practice public accounting. | b. PCAOB |
| 3. A report filed to indicate a significant event. | c. Securities Exchange Commission |
| 4. Sets professional standards and rules for auditors. | d. Form 10-k |
| 5. Oversees accounting firms who audit public companies. | e. IAASB |
| 6. An organizational structure where the owners are taxed like a partnership and have limited personal liability. | f. Form S-1 |
| 7. A report that is filed when a company wishes to issue new securities. | g. Due professional care |
| 8. The methods used to ensure the firm meets its professional responsibilities to clients and others. | h. Limited Liability Partnership |
| 9. Assists in providing investors with reliable information. | i. Professional Corporation |
| 10. Requires annual inspections of accounting firms auditing > 100 issuers. | j. Limited Liability Company |
| 11. Practice monitoring by a CPA firm for another CPA firm. | k. Peer review |
| 12. Fulfilling duties diligently and carefully. | l. 1933 Securities Act |
| 13. Requires a registration statement. | m. 1934 Securities Act |
| | n. Form 8-k |
| | o. State Regulation |
| | p. Code of Professional Conduct |
| | q. Quality Control Standards |
| | r. GAAS Standards |

Answer:

1. i
2. o
3. n
4. a
5. b
6. j
7. f
8. q
9. c
10. b
11. k
12. g
13. l

Terms: AICPA; PCAOB; Securities Exchange Commission; Form S-1; Form 8-K; Due professional care; Professional Corporation; Limited Liability Company; Peer review; 1933 Securities Act; State Regulation; Quality Control Standards

Diff: Moderate

Objective: LO 2-1, LO 2-2, LO 2-3, LO 2-6, and LO 2-7

AACSB: Reflective thinking skills

11) Quality controls are established for the entire CPA firm whereas GAAS are applicable to the individual engagement.

A) True

B) False

Answer: A

Terms: Quality controls and GAAS

Diff: Moderate

Objective: LO 2-7

AACSB: Reflective thinking skills