### Chapter 1

### Introduction and Overview of Audit and Assurance

#### Question Type: True or False

##### GAAP and IFRS are examples of applicable financial reporting framework.

A. True

B. False

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA FC: Reporting, AACSB: Communication, Learning Objective: LO1.1, Solution: The applicable financial reporting framework refers to the set of standards used in preparing the historical financial statements, such as GAAP, IFRS or a Federal Income Tax Basis of Accounting.

##### Review of financial forecasts falls under attestation services.

A. True

B. False

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA FC: Measurement Analysis and Interpretation, AACSB: Ethics, Learning Objective: LO1.1, Solution: Attestation services (under the umbrella of assurance services) include review of historical financial statements, review of financial forecasts, and examination of internal control.

##### Within a U.S. context, the applicable financial reporting framework is typically Generally Accepted Accounting Principles (GAAP).

A. True

B. False

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA FC: Measurement Analysis and Interpretation, AACSB: Ethics, Learning Objective: LO1.2, Solution: Within a U.S. context, the applicable financial reporting framework is typically generally accepted accounting principles (GAAP).

##### Private companies, or non-issuers, are not required by the U.S. government to have an annual financial statement audit

A. True

B. False

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA FC: Reporting, AACSB: Analytic, Learning Objective: LO1.2, Solution: Private companies, or non-issuers, are not required by the U.S. government to have an annual financial statement audit, but often other interested users, such as a bank or lender, may request that a private company provide audited financial statements.

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

A. True

B. False

Answer: A, Taxonomy: Comprehension, Difficulty: Easy, AICPA PC: Communication, AACSB: Analytic, Learning Objective: LO1.3, Solution: Complexity: Financial statements are complex, the amounts are often affected by significant estimates, and the disclosures often require significant knowledge and experience to evaluate. Most financial statement users do not have the accounting and legal knowledge to assess the reasonableness of complex accounting and disclosure choices being made by the company.

##### In financial accounting, the balance sheet is a statement of financial position

A. True

B. False

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA PC: Communication, AACSB: Analytic, Learning Objective: LO1.3, Solution: In financial accounting, the financial statements include the balance sheet (statement of financial position), income statement (statement of comprehensive income), statement of cash flows, statement of changes in equity and accompanying notes.

##### Business valuation falls within the purview of non-assurance services.

A. True

B. False

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA FC: Measurement Analysis and Interpretation, AACSB: Analytic, Learning Objective: LO1.4, Solution: Many of these accounting firms provide non-assurance (or non-audit) services as well as assurance services. These non-assurance services include management consulting, business valuation, mergers and acquisitions, insolvency, tax and accounting services.

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

A. True

B. False

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA BB: Governance Perspective, AACSB: Ethics, Learning Objective: LO1.5, Solution: The Securities Exchange Act of 1934 regulates the ongoing trading of securities after the initial public offering and requires the annual audit of a public company’s financial statements.

##### The Securities Act of 1933 enhances annual financial disclosures for public companies and placed more emphasis on corporate responsibility.

A. True

B. False

Answer: B, Taxonomy: Knowledge, Difficulty: Easy, AICPA BB: Governance Perspective, AACSB: Ethics, Learning Objective: LO1.5, Solution: The Securities Act of 1933 regulates the disclosure of financial information in a company’s initial public offering of stock and requires that the financial information be audited.

##### Neither client characteristics nor actions of the auditor affect the audit risk.

A. True

B. False

Answer: B, Taxonomy: Knowledge, Difficulty: Easy, AICPA FC: Reporting, AACSB: Ethics, Learning Objective: LO1.6, Solution: Audit risk is affected by client characteristics as well as actions of the auditor.

##### Materiality is a relative concept, and it differs from company to company and from year to year for a given company.

A. True

B. False

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA FC: Reporting, AACSB: Ethics, Learning Objective: LO1.6, Solution: Materiality is a relative concept, and it differs from company to company and from year to year for a given company. Auditors design an audit to provide reasonable assurance that the financial statements are free of material misstatement. However, auditors do not design an audit to look for immaterial misstatements because they would not influence a financial statement user.

##### When auditors determine that the financial statements of a public company are presented fairly in accordance with the applicable financial reporting framework, they issue a type of report that PCAOB standards call “the standard clean report.”

A. True

B. False

Answer: B, Taxonomy: Knowledge, Difficulty: Easy, AICPA FC: Reporting, AACSB: Ethics, Learning Objective: LO1.6, Solution: If auditors have determined the financial statements are presented fairly in accordance with the applicable financial reporting framework, they issue the standard unqualified report. The PCAOB standards use the term “unqualified” report.

##### In an unqualified audit report on the financial statements of a public company, the concluding statement of the scope paragraph mentions reasonable basis for the audit firm’s opinion.

A. True

B. False

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA FC: Reporting, AACSB: Ethics, Learning Objective: LO1.6, Solution: The scope paragraph explains, in brief terms, the process of conducting an audit. It mentions the concept of reasonable assurance about whether the financial statements are free of material misstatement. It includes an explicit statement that PCAOB audit standards were followed because the audit pertains to a public company. The scope paragraph also includes a brief discussion of the professional judgments made during the audit. Finally, it concludes with a statement that the audit firm believes that its audit provides a reasonable basis for its opinion.

##### In an audit report on the effectiveness of ICFR for a public company, the scope paragraph states the different responsibilities of management and auditors.

A. True

B. False

Answer: B, Taxonomy: Knowledge, Difficulty: Easy, AICPA BB: Governance Perspective, AACSB: Communication, Learning Objective: LO1.7, Solution: In an audit report on the effectiveness of ICFR for a public company, the basis for opinion paragraph states the different responsibilities of management and auditors. Like the audit report on the financial statements, this paragraph references registration with the PCAOB and independence requirements of the SEC and other federal securities laws.

##### In an audit report on the effectiveness of ICFR for a public company, the scope paragraph mentions that auditors are only required to obtain reasonable assurance about whether the company maintained, in all material respects, effective ICFR.

A. True

B. False

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA BB: Governance Perspective, AACSB: Communication, Learning Objective: LO1.7, Solution: In an audit report on the effectiveness of ICFR for a public company, the scope paragraph explains that auditors conducted their audit in accordance with the standards of the PCAOB. In brief terms, it explains the process of conducting an audit of the effectiveness of ICFR. It mentions that auditors are only required to obtain reasonable assurance about whether the company maintained, in all material respects, effective ICFR. It concludes with a statement that the audit firm believes its audit provides a reasonable basis for its opinion.

##### A financial statement user’s expectations are only impacted by legislation.

A. True

B. False

Answer: B, Taxonomy: Knowledge, Difficulty: Easy, AICPA FC: Measurement Analysis and Interpretation, AACSB: Communication, Learning Objective: LO1.8, Solution: A financial statement user’s expectations are often impacted by audit standards, ethical standards, regulations, legislation, and firm policy and procedures.

##### The audit expectation gap is caused by user expectations such as: The auditor will catch all instances of fraud.

A. True

B. False

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA FC: Reporting, AACSB: Communication, Learning Objective: LO1.8, Solution: The audit expectation gap is caused by unrealistic user expectations such as: the auditor is providing complete assurance; the auditor is guaranteeing the future viability of the entity; an unmodified audit opinion is an indicator of complete accuracy of the financial statements; the auditor will definitely find any and all fraud; and that the auditor has checked all transactions.

#### Question Type: Multiple choice

##### Identify a service that falls under audit services.

A. examination of historical financial statements

B. compilation of historical financial statements

C. inspection of website security

D. review of financial forecast

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA FC: Measurement Analysis and Interpretation, AACSB: Ethics, Learning Objective: LO1.1, Solution: Examination of historical financial statements comes under audit services.

##### Examination of internal controls is a service that comes under \_\_\_\_\_\_\_ services, which fall under \_\_\_\_\_\_\_ services.

A. attestation; assurance

B. assurance; attestation

C. acceptable; assurance

D. attestation; audit

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA FC: Measurement Analysis and Interpretation, AACSB: Ethics, Learning Objective: LO1.1, Solution: Attestation services (under the umbrella of assurance services) include review of historical financial statements, review of financial forecast, and examination of internal control.

##### Compared to an audit of historical financial statements, a review engagement is \_\_\_\_\_\_\_.

A. less extensive and also less expensive

B. more extensive and also more expensive

C. less extensive but more expensive

D. more extensive but less expensive

Answer: A, Taxonomy: Comprehension, Difficulty: Easy, AICPA FC: Measurement Analysis and Interpretation, AACSB: Ethics, Learning Objective: LO1.1, Solution: In a review engagement, the practitioner expresses limited assurance that no material modifications need to be made to the financial statements. So a review of historical financial statements is a less extensive, and therefore, less expensive service that can be very useful for smaller private companies.

##### Who are the only licensed accounting professionals in the United States?

A. Certified Public Accountants (CPA)

B. Chartered Accounts (CA)

C. Financial Accountants (FA)

D. Chief financial and operating officer (CFOO)

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA FC: Measurement Analysis and Interpretation, AACSB: Ethics, Learning Objective: LO1.1, Solution: Certified Public Accountants (CPA) are the only licensed accounting professionals in the United States.

##### As attestation services encompass more than just the inspection of historical financial statements, the term \_\_\_\_\_\_\_ is used rather than \_\_\_\_\_\_\_.

A. practitioner; auditor

B. auditor; practitioner

C. intended user; auditor

D. intended user; practitioner

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA FC: Reporting, AACSB: Communication, Learning Objective: LO1.1, Solution: In attestation services, the term practitioner is used rather than auditor because attestation services encompass more than just the audit of historical financial statements.

##### What services are defined as independent professional services that improve the quality of information, or its context, for decision makers?

A. assurance services

B. attestation services

C. absolute assurance

D. audit services

Answer: A, Taxonomy: Comprehension, Difficulty: Easy, AICPA FC: Reporting, AACSB: Communication, Learning Objective: LO1.1, Solution: Assurance services are defined as independent professional services that improve the quality of information, or its context, for decision makers.

##### The most common assurance service is the \_\_\_\_\_\_\_\_.

A. audit of a company’s historical financial statements

B. compilation of financial statements

C. review of a company’s financial controls

D. review of a company’s historical financial statements

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA FC: Reporting, AACSB: Communication, Learning Objective: LO1.1, Solution: The audit of a company’s historical financial statements is the most common assurance service.

##### A review of historical financial statements is an example of \_\_\_\_\_\_\_\_.

A. attestation service

B. absolute assurance

C. financial forecast

D. applicable financial reporting framework

Answer: A, Taxonomy: Comprehension, Difficulty: Easy, AICPA FC: Reporting, AACSB: Communication, Learning Objective: LO1.1, Solution: An example of an attestation service is a review of historical financial statements.

##### Assurance, attestation, and auditing are similar because all three represent a common process of \_\_\_\_\_\_\_.

A. taking information prepared by someone else and comparing that information to an established set of criteria.

B. compiling and reviewing historical financial statements and providing non-financial information.

C. compiling historical financial statements and providing non-financial information and web security.

D. reviewing financial forecast, examining internal controls, and providing website security.

Answer: A, Taxonomy: Comprehension, Difficulty: Easy, AICPA FC: Reporting, AACSB: Communication, Learning Objective: LO1.1, Solution: The terms assurance, attestation, and auditing are sometimes used interchangeably, but they actually represent different types of services. They are similar because they all represent a common process of an independent accounting firm taking information prepared by someone else and comparing that information to an established set of criteria.

##### Which of the following is true of assurance services?

A. Both attestation and auditing services fall under the term of assurance services.

B. The term information refers to subject matter that is an entire system, not standalone data.

C. The services are performed by someone who was involved with the creation of the information.

D. The intended user is an independent Certified Public Accountant qualified to perform the auditing service.

Answer: A, Taxonomy: Comprehension, Difficulty: Easy, AICPA FC: Reporting, AACSB: Communication, Learning Objective: LO1.1, Solution: Both attestation and auditing services fall under the term of assurance services. The term independent implies that the service is performed by someone who was not involved with the creation of the information and who is objective in the evaluation of the information. The term information refers to subject matter that can be standalone data or entire systems. The auditor refers to an independent Certified Public Accountant, or CPA, who is qualified to perform the auditing service.

##### When CPAs are hired to report on the integrity of financial forecasts and reports on financial reporting processes, it is called an \_\_\_\_\_\_\_\_\_\_\_\_\_\_.

A. attestation service

B. absolute assurance

C. applicable financial reporting framework

D. audit service

Answer: A, Taxonomy: Comprehension, Difficulty: Easy, AICPA FC: Reporting, AACSB: Communication, Learning Objective: LO1.1, Solution: Companies produce financial information that goes beyond historical financial statements. Examples include financial forecasts and reports on financial reporting processes. When CPAs are hired to report on the integrity of this type of financial information, it is called an attestation service.

##### In assurance services, the term “information” refers to subject matter that is \_\_\_\_\_\_\_\_\_\_\_\_\_.

A. historical or prospective

B. created by independent or in-house services

C. financial and outside the purview of the non-financial

D. internal to a company only

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA FC: Reporting, AACSB: Communication, Learning Objective: LO1.1, Solution: In the assurance services, the term information refers to subject matter that can be financial or non-financial, historical or prospective, or standalone data or entire systems, internal or external to a company.

##### Which terms does the textbook claim are used interchangeably, but actually represent different types of services?

* 1. assurance, attestation, and auditing
  2. accounting, auditing, and assurance
  3. accounting, attestation, and auditing
  4. assurance, attestation, and accounting

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA FC: Reporting, AACSB: Analytic, Learning Objective: LO1.1, Solution: Assurance, attestation and auditing are used interchangeably but represent different services.

##### Which of the following is included as a focus of assurance services?

* 1. Compilation of historical financial statements
  2. Examination of internal controls
  3. Review of historical financial statements
  4. Review of financial forecast

Answer: C, Taxonomy: Comprehension, Difficulty: Easy, AICPA FC: Reporting, AACSB: Analytic, Learning Objective: LO1.1, Solution: A review is a type of assurance service.

##### A key similarity between assurance, attestation, and auditing services is \_\_\_\_\_\_\_\_.

* 1. the comparison of information prepared by someone else against an established set of criteria
  2. the comparison of actual output to projected output
  3. the comparison of financial accounting data to managerial accounting data
  4. the comparison of financial audit data to tax audit data

Answer: A, Taxonomy: Comprehension, Difficulty: Easy, AICPA FC: Reporting, AACSB: Analytic, Learning Objective: LO1.1, Solution: Assurance, attestation, and auditing services involve the comparison of information prepared by someone else against an established set of criteria.

##### The purpose of audit services is to provide \_\_\_\_\_\_\_\_.

* 1. financial statement users with an opinion as to the fair presentation of the financial reporting
  2. management with an opinion as to the fairness of the company’s managerial accounting procedures
  3. investment advice to the company
  4. limited assurance that no material modifications need to be made to the financial statements

Answer: A, Taxonomy: Comprehension, Difficulty: Easy, AICPA FC: Reporting, AACSB: Analytic, Learning Objective: LO1.1, Solution: The purpose of an audit is to provide financial statement users with an opinion as to the fair presentation of the financial reporting.

##### Which are the most specific services provided by the auditor?

* 1. Compilation services
  2. Audit services
  3. Attestation services
  4. Assurance services

Answer: B, Taxonomy: Comprehension, Difficulty: Easy, AICPA FC: Reporting, AACSB: Analytic, Learning Objective: LO1.1, Solution: Audit services are the most specific.

##### Which is the most inclusive or broadest service provided by the auditor?

* 1. Audit services
  2. Attestation services
  3. Assurance services
  4. A review of historical financial statements

Answer: C, Taxonomy: Comprehension, Difficulty: Easy, AICPA FC: Reporting, AACSB: Analytic, Learning Objective: LO1.1, Solution: Assurance services are the broadest service.

##### The only professional who can audit a set of historical financial statements for a public or private company in the United States is \_\_\_\_\_\_\_\_.

* 1. a Certified Public Accountant (CPA)
  2. a Certified Fraud Examiner (CFE)
  3. the IRS
  4. a loan officer

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA FC: Reporting, AACSB: Analytic, Learning Objective: LO1.1, Solution: A CPA is the only professional in the United States who can audit a set of historical financial statements for a public or private company.

##### The set of standards used in preparing the historical financial statements, such as GAAP or IFRS, is referred to as \_\_\_\_\_\_\_\_.

* 1. the applicable financial reporting framework
  2. Generally Accepted Auditing Standards (GAAS)
  3. material modifications
  4. a review of historical financial statements

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA FC: Reporting, AACSB: Analytic, Learning Objective: LO1.1, Solution: The set of standards used in preparing the historical financial statements is referred to as the applicable financial reporting framework.

##### Any group that will be using the financial statements to make decisions, such as investors and creditors, is known as \_\_\_\_\_\_\_\_.

* 1. intended users
  2. groups of standing
  3. decision-makers
  4. practitioners

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA FC: Reporting, AACSB: Analytic, Learning Objective: LO1.1, Solution: Intended users are any group that will be using the financial statements to make decisions.

##### Which of the following is not one of the three E’s needed to become a licensed CPA?

* 1. Education
  2. Examination
  3. Experience
  4. Efficiency

Answer: D, Taxonomy: Knowledge, Difficulty: Easy, AICPA FC: Reporting, AACSB: Analytic, Learning Objective: LO1.1, Solution: The three E’s are education, examination, and experience.

##### The only licensed accounting professionals in the United States are:

* 1. Certified Public Accountants
  2. Chartered Accountants
  3. Certified Internal Auditors
  4. Certified Fraud Examiners

Answer: A, Taxonomy: Comprehension, Difficulty: Easy, AICPA FC: Reporting, AACSB: Analytic, Learning Objective: LO1.1, Solution: CPAs are the only licensed accounting professionals in the United States.

##### Assurance services are defined as \_\_\_\_\_\_\_\_.

* 1. independent professional services that improve the quality of information, or its context, for decision makers
  2. individual provisional services to improve internal controls for financial statement users
  3. individual prospective financial statement quality
  4. independent information improvement

Answer: A, Taxonomy: Comprehension, Difficulty: Easy, AICPA FC: Reporting, AACSB: Analytic, Learning Objective: LO1.1, Solution: Assurance services are independent professional services that improve the quality of information, or its context, for decision makers.

##### Which type of entity generally finds a review of historical financial statements to be the most useful?

* 1. Large public corporations
  2. Small public corporations
  3. Large private corporations
  4. Small private corporations

Answer: D, Taxonomy: Comprehension, Difficulty: Easy, AICPA FC: Reporting, AACSB: Analytic, Learning Objective: LO1.1, Solution: Small private corporations typically find reviews to be the most useful.

##### Which of the following is a characteristic of an audit of historical financial statements?

* 1. It provides limited assurance that no material modifications need to be made to the financial statements.
  2. It expresses an opinion on the fair presentation of the financial statements.
  3. It is the same as an examination of internal controls.
  4. It is broader than a review engagement.

Answer: B, Taxonomy: Comprehension Application, Difficulty: Easy, AICPA FC: Reporting, AACSB: Analytic, Learning Objective: LO1.1, Solution: An audit expresses an opinion on the fair presentation of the financial statements.

##### Which of the following is not one of the four sections tested on the CPA exam?

* 1. Auditing and Attestation
  2. Business Environment and Concepts
  3. Regulation
  4. Internal Controls

Answer: D, Taxonomy: Knowledge, Difficulty: Easy, AICPA FC: Reporting, AACSB: Analytic, Learning Objective: LO1.1, Solution: Internal controls are not one of the four parts of the CPA exam.

##### What is the final step in becoming a licensed CPA?

* 1. Taking the CPA exam
  2. Meeting the educational requirements
  3. Work experience
  4. Evidence of personal integrity

Answer: C, Taxonomy: Comprehension, Difficulty: Easy, AICPA FC: Reporting, AACSB: Analytic, Learning Objective: LO1.1, Solution: The final step is getting the required work experience.

##### Independent professional attestation services improve the quality of information. Quality is best described as an improvement in informational \_\_\_\_\_\_\_\_.

* 1. relevance and reliability.
  2. financial and nonfinancial qualities
  3. historical and prospective qualities
  4. internal and external qualities

Answer: A, Taxonomy: Comprehension : Application, Difficulty: Easy, AICPA FC: Reporting, AACSB: Analytic, Learning Objective: LO1.1, Solution: Relevance and reliability improve the quality of information.

##### The term practitioner would be least likely to be used when referring to the performance of \_\_\_\_\_\_\_\_.

* 1. audit services
  2. attestation services
  3. assurance services
  4. bookkeeping services

Answer: A, Taxonomy: Comprehension, Difficulty: Easy, AICPA FC: Reporting, AACSB: Analytic, Learning Objective: LO1.1, Solution: The term practitioner would least likely be used when referring to an audit because it is so specific that professionals who perform audits are called auditors.

##### A review of historical financial statements as compared to an audit of historical financial statements \_\_\_\_\_\_\_\_.

* 1. is more extensive in terms of the work product required
  2. is typically less expensive
  3. provides greater assurance
  4. provides an opinion

Answer: B, Taxonomy: Comprehension, Difficulty: Easy, AICPA FC: Reporting, AACSB: Analytic, Learning Objective: LO1.1, Solution: A review is typically less expensive than an audit because much less time and effort are involved.

##### The term independent with respect to assurance services implies that the service is \_\_\_\_\_\_\_\_.

* 1. performed by someone who was not involved with the creation of the information.
  2. performed by someone who was involved with the creation of the information and, therefore, fully understands it.
  3. performed by a company employee.
  4. is subjective.

Answer: A Taxonomy: Comprehension, Difficulty: Easy, AICPA FC: Reporting, AACSB: Analytic, Learning Objective: LO1.1, Solution: Independence implies that the service is performed by someone who was not involved with the creation of the information.

##### Examination of non-financial information falls under \_\_\_\_\_\_\_ services and outside of\_\_\_\_\_\_\_ services.

A. assurance; audit

B. attestation; assurance

C. audit; assurance

D. attestation; audit

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA FC: Measurement Analysis and Interpretation, AACSB: Ethics, Learning Objective: LO1.1, Solution: Assurance services include compilation of historical statements, website security, IT operations, and non-financial information. Attestation services (under the umbrella of assurance services) include review of historical financial statements, review of financial forecast, and examination of internal control. Historical financial statements come under audit services.

##### Among the various processes relating to auditing and assurance standards, the largest umbrella represents \_\_\_\_\_\_\_\_ services.

A. assurance

B. attestation

C. audit

D. review

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA FC: Measurement Analysis and Interpretation, AACSB: Ethics, Learning Objective: LO1.1, Solution: Among the various processes relating to auditing and assurance standards, the largest umbrella represents assurance services: independent professional services that improve the quality of information, or its context, for decision makers.

##### Within a U.S. context, the applicable financial reporting framework is typically \_\_\_\_\_\_\_.

A. Generally Accepted Accounting Principles (GAAP)

B. International Standard on Quality Control (ISQC)

C. Auditing and Assurance Standards Board (AASB)

D. International Financial Reporting Standards (IFRS)

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA FC: Measurement Analysis and Interpretation, AACSB: Ethics, Learning Objective: LO1.2, Solution: Within a U.S. context, the applicable financial reporting framework is typically generally accepted accounting principles (GAAP).

##### Which two audits does an integrated audit combine?

A. A financial statement audit and an audit of the effectiveness of ICFR

B. A financial statement audit and a compliance audit

C. A compliance audit and an audit of the effectiveness of ICFR

D. A performance audit and an environmental audit

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA FC: Measurement Analysis and Interpretation, AACSB: Ethics, Learning Objective: LO1.2, Solution: An integrated audit is an audit that combines the financial statement audit with an audit of the effectiveness of ICFR.

##### The audit related to which of the following is specifically meant to express an opinion on the effectiveness of the company’s system of internal controls over financial reporting?

A. ICFR

B. GAAP

C. FASB

D. AICPA

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA FC: Measurement Analysis and Interpretation, AACSB: Ethics, Learning Objective: LO1.2, Solution: Public companies in the U.S. are also required to have an audit of internal controls over financial reporting (ICFR). The objective in an audit of ICFR is to express an opinion on the effectiveness of the company’s system of internal controls over financial reporting (AS 2201.03) following section 404(b) of the Sarbanes Oxley Act of 2002.

##### Which audit involves gathering evidence to determine whether the person or entity under review has followed the rules, policies, procedures, laws and regulations with which they must conform?

A. A compliance audit

B. A performance audit

C. An integrated audit

D. An internal audit

Answer: A, Taxonomy: Comprehension, Difficulty: Easy, AICPA FC: Measurement Analysis and Interpretation, AACSB: Ethics, Learning Objective: LO1.2, Solution: A compliance audit involves gathering evidence to determine whether the person or entity under review has followed the rules, policies, procedures, laws and regulations with which they must conform.

##### What is a compliance audit?

A. an audit to determine whether the entity has conformed with regulations, rules or processes

B. an assessment of the economy, efficiency and effectiveness of an organization’s operations

C. an evaluation and improvement of risk management, internal control procedures and elements of the governance process

D. an assessment of the company’s financial statements

Answer: A, Taxonomy: Comprehension, Difficulty: Easy, AICPA FC: Measurement Analysis and Interpretation, AACSB: Ethics, Learning Objective: LO1.2, Solution: A compliance audit is an audit to determine whether the entity has conformed to regulations, rules, or processes.

##### What is the applicable financial reporting framework in the U.S. known as?

* 1. GAAP
  2. GAAS
  3. IFRS
  4. The Internal Revenue Code

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA FC: Reporting, AACSB: Analytic, Learning Objective: 1.2 Solution: GAAP is the applicable financial reporting framework in the U.S.

##### Public companies, or issuers, in the U.S. are \_\_\_\_\_\_\_\_.

* 1. required by the federal government to have quarterly financial statement audits
  2. required by the federal government to have annual financial statement audits
  3. required by the federal government to have semi-annual financial statement audits
  4. not required by the federal government to have financial statement audits

Answer: B : Knowledge: Knowledge, Difficulty: Easy, AICPA FC: Reporting, AACSB: Analytic, Learning Objective: 1.2 Solution: Public companies in the U.S. are required to have annual financial statement audits.

##### Private companies, or non-issuers, in the U.S. are \_\_\_\_\_\_\_\_.

* 1. required by the federal government to have quarterly financial statement audits
  2. required by the federal government to have annual financial statement audits
  3. required by the federal government to have semi-annual financial statement audits
  4. not required by the federal government to have financial statement audits

Answer: D, Taxonomy: Knowledge, Difficulty: Easy, AICPA FC: Reporting, AACSB: Analytic, Learning Objective: 1.2 Solution: Private companies in the U.S. are not required by the federal government to have financial statement audits.

##### Which of the following statements is true?

* 1. Often interested users, like banks, ask private companies or non-users to provide audited financial statements.
  2. Public users are required to have three audits a year.
  3. Public users are required to have an audit of internal financial forecast reports (IFFRs).
  4. For efficiency purposes, the three required audits for public companies are performed at the same time.

Answer: A, Taxonomy: Comprehension, Difficulty: Easy, AICPA FC: Reporting, AACSB: Analytic, Learning Objective: 1.2 Solution: Often interested users, like banks, ask private companies or non-users to provide audited financial statements.

##### ICFR stands for:

* 1. internal controls over financial reporting.
  2. internal controls for reporting.
  3. international controls over financial reporting.
  4. internal controls over forecast reports.

Answer: A Taxonomy, TAXONOMY: K, Difficulty: Easy, AICPA FC: Reporting, AACSB: Analytic, Learning Objective: 1.2 Solution: ICFR stands for internal control over financial reporting.

##### The limitations of an audit are NOT caused by \_\_\_\_\_\_\_\_.

* 1. the nature of financial reporting.
  2. the nature of audit procedures.
  3. the need for the audit to be conducted within a reasonable period of time at a reasonable cost.
  4. a guarantee that the financial statements are free from error

Answer: D, Taxonomy: C, Difficulty: Easy, AICPA FC: Reporting, AACSB: Analytic, Learning Objective: 1.2 Solution: Limitations of an audit are caused by the nature of financial reporting, the nature of audit procedures, and the need for an audit to be conducted within a reasonable period of time.

##### The nature of audit procedures refers to the \_\_\_\_\_\_\_\_.

* 1. reliance on evidence provided by the client and its management
  2. use of judgment when preparing financial statements due to the subjectivity required when arriving at accounting estimates
  3. materiality of misstatement
  4. pressures auditors face to complete their audit within a certain time frame at a reasonable cost

Answer: A, Taxonomy: C, Difficulty: Easy, AICPA FC: Reporting, AACSB: Analytic, Learning Objective: 1.2 Solution: The nature of audit procedures refers to the reliance on evidence provided by the client and its management.

##### A financial statement audit is conducted to \_\_\_\_\_\_\_\_.

* 1. enhance the reliability and credibility of the information included in the financial statements
  2. guarantee that the financial statements are free from error or fraud
  3. determine whether financial documents were altered by those committing a fraud
  4. focus on finding all misstatements in the financial records

Answer A Taxonomy, Taxonomy: C, Difficulty: Easy, AICPA FC: Reporting, AACSB: Analytic, Learning Objective: 1.2 Solution: A financial statement audit is conducted to enhance the reliability and credibility of the information included in the financial statements.

##### An integrated audit refers to two audits performed at the same time, or \_\_\_\_\_\_\_\_.

* 1. an audit on the effectiveness of internal controls and an audit of the financial statements for external purposes.
  2. an internal audit and an external audit with the same identical objectives.
  3. an audit for intentional material misstatements and an audit for errors.
  4. an audit based on time constraints and an audit based on cost constraints.

Answer A, Taxonomy: Comprehension, Difficulty: Easy, AICPA FC: Reporting, AACSB: Analytic, Learning Objective: 1.2 Solution: An integrated audit refers to an audit on the effectiveness of internal controls and an audit of the financial statements for external purposes.

##### The nature of audit procedures can refer to the concept of \_\_\_\_\_\_\_\_.

* 1. consistency
  2. timeliness
  3. effectiveness
  4. materiality

Answer: D, Taxonomy: C, Difficulty: Easy, AICPA FC: Reporting, AACSB: Analytic, Learning Objective: 1.2 Solution: The nature of audit procedures can refer to the concept of materiality.

##### Pressures of time and money may affect the audit due to all of the following EXCEPT \_\_\_\_\_\_\_\_.

* 1. clients want to issue their financial statements by a certain date
  2. clients refusing to pay additional fees for additional audit effort and time
  3. pressures within the CPA firm to complete all audits on a timely basis to avoid incurring costs that may not be recovered
  4. pressures by shareholders to find all misstatements in the financial reports

Answer: D, Taxonomy: Comprehension, Difficulty: Easy, AICPA FC: Reporting, AACSB: Analytic, Learning Objective: 1.2 Solution: Pressures by shareholders to find all misstatements in the financial reports do not affect the pressures of time and money in and audit.

##### If the auditors do not have access to all the information relevant to the audit, this is known as a(an) \_\_\_\_\_\_\_\_.

* 1. material misstatement
  2. limitation in scope
  3. estimate
  4. sampling technique

Answer: B, Taxonomy: Knowledge, Difficulty: Easy, AICPA FC: Reporting, AACSB: Analytic, Learning Objective: 1.6 Solution: A limitation in scope occurs when the auditors do not have access to all the information relevant to the audit.

##### What type of audit involves gathering evidence to determine whether the person or entity under review has followed the rules?

* 1. A compliance audit
  2. An operational audit
  3. A financial statement audit
  4. An integrated audit

Answer: A, Taxonomy: Comprehension, Difficulty: Easy, AICPA FC: Reporting, AACSB: Analytic, Learning Objective: 1.2 Solution: A compliance audit involves gathering evidence to determine whether a person or entity under review has followed the rules.

##### What type of audit is concerned with the economy, efficiency and effectiveness of an organization’s activities?

* 1. A compliance audit
  2. An operational audit
  3. A financial statement audit
  4. An integrated audit

Answer: B, Taxonomy: Comprehension, Difficulty: Easy, AICPA FC: Reporting, AACSB: Analytic, Learning Objective: 1.2 Solution: An operational audit is concerned with the economy, efficiency and effectiveness of an organization’s activities.

##### What type of audit provides an opinion by the auditor about whether the financial statements are presented fairly in accordance with an applicable financial reporting framework?

* 1. A compliance audit
  2. An operational audit
  3. A financial statement audit
  4. An audit on the effectiveness of ICFR

Answer: C, Taxonomy: Comprehension, Difficulty: Easy, AICPA FC: Reporting, AACSB: Analytic, Learning Objective: 1.2 Solution: A financial statement audit provides an opinion about whether the financial statements are presented fairly in accordance with an applicable financial reporting framework.

##### What type of audit is conducted to provide assurance about various aspects of an organization’s activities rather than the reliability of financial statements? a(an)

* 1. compliance audit
  2. operational audit
  3. financial statement audit
  4. internal audit

Answer: D, Taxonomy: Knowledge, Difficulty: Easy, AICPA FC: Reporting, AACSB: Analytic, Learning Objective: 1.2 Solution: An internal audit is conduced to provide assurance about various aspects of an organization’s activities.

##### Those charged with governance are the ***\_\_\_\_\_\_\_\_.***

* 1. CEO, CFO, and COO
  2. board of directors and management of an entity
  3. stockholders
  4. auditors

Answer: B, Taxonomy: Knowledge, Difficulty: Easy, AICPA BB: Governance Perspective, AACSB: Analytic, Learning Objective: 1.2 Solution: The board of directors and management of an entity are those charged with governance.

##### In the United States, what entities are required by the federal government to have an annual financial statement audit?

A. public companies or issuers

B. private companies or issuers

C. public companies or non-issuers

D. private companies or non-issuers

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA FC: Measurement Analysis and Interpretation, AACSB: Ethics, Learning Objective: LO1.2, Solution: Public companies, or issuers, in the U.S. are required by the federal government to have an annual financial statement audit. Private companies, or non-issuers, are not required by the U.S. government to have an annual financial statement audit, but often other interested users request that a private company provide audited financial statements.

##### Who among the following users of the financial statement of a company may be particularly interested in evaluating whether the company is paying a fair amount of taxes given its reported earnings, and to gain a better understanding of the company’s activities?

A. government

B. general pubic

C. employees

D. investors

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA FC: Measurement Analysis and Interpretation, AACSB: Analytic, Learning Objective: LO1.3, Solution: Governments may read financial statements to determine whether the company is complying with regulations, to evaluate if the company is paying a fair amount of taxes given its reported earnings, and to gain a better understanding of the company’s activities. A company in receipt of government grants often must provide a copy of its audited financial statements when applying for a grant and when reporting on how grant funds have been spent.

##### Since users of financial statements make financial decisions that have real consequences, it is very important that users can depend on the information contained in the financial statements. What term captures this problem?

A. reliability

B. competing incentives

C. complexity

D. remoteness

Answer: A, Taxonomy: Comprehension, Difficulty: Easy, AICPA FC: Measurement Analysis and Interpretation, AACSB: Analytic, Learning Objective: LO1.3, Solution: Financial statement users are concerned with the reliability of the information contained in the financial statements. Since they use that information to make decisions that have real consequences, it is very important that users can rely on the information contained in the financial statements.

##### Most financial accounting and disclosure choices being made by the company are complicated and often require significant technical knowledge and experience in order to understand. What term captures this problem?

A. Complexity

B. Remoteness

C. Competing incentives

D. Reliability

Answer: A, Taxonomy: Comprehension, Difficulty: Easy, AICPA FC: Measurement Analysis and Interpretation, AACSB: Ethics, Learning Objective: LO1.3, Solution: Financial statements are complex, the amounts are often affected by significant estimates, and the disclosures often require significant knowledge and experience to evaluate. Most financial statement users do not have the accounting and legal knowledge to assess the reasonableness of complex accounting and disclosure choices being made by the company.

##### Among the reasons why users demand an audit of financial statements, what is the problem of competing incentives?

A. The company has a reason to disclose information in a way that presents it in favorable light.

B. Financial statement users lack accounting and legal knowledge to understand accounting and disclosure choices.

C. Financial statement users to not have access to the company under review and thus face difficulty in determining whether the statements are fair.

D. Financial statement users need reliable information in order to make decisions that have real consequences.

Answer: A, Taxonomy: Comprehension, Difficulty: Easy, AICPA PC: Communication, AACSB: Analytic, Learning Objective: LO1.3, Solution: Competing incentives: Company managers have an incentive to disclose the information contained in the financial statements in a way that presents their performance in the best possible light. Users may find it difficult or impossible to identify when management is presenting biased information.

##### Which of the following falls within the purview of financial accounting?

A. Changes in equity

B. Management consulting

C. Business valuation

D. Mergers and acquisitions

Answer: A, Taxonomy: Comprehension, Difficulty: Easy, AICPA FC: Measurement Analysis and Interpretation, AACSB: Analytic, Learning Objective: LO1.4, Solution: Financial accounting looks into statements that include the balance sheet (statement of financial position), income statement (statement of comprehensive income), statement of cash flows, statement of changes in equity and accompanying notes.

##### Which of the following comes under the purview of the Public Company Accounting Oversight Board?

A. Auditing Standards (AS)

B. Statements on Auditing Standards (SAS)

C. Statements on Standards for Attestation Engagement (SSAE)

D. Statements on Quality Control Standards (SQCS)

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA BB: Governance Perspective, AACSB: Ethics, Learning Objective: LO1.5, Solution: Standards issued by the PCAOB are called Auditing Standards (AS), which provide minimum requirements and guidance for auditing services.

##### Which of the following is a private professional membership organization of CPAs representing the accounting profession?

A. AICPA

B. PCAOB

C. ASB

D. IAASB

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA BB: Governance Perspective, AACSB: Ethics, Learning Objective: LO1.5, Solution: The AICPA is a private professional membership organization of CPAs representing the accounting profession. There are over 430,000 members in 137 countries (www.aicpa.org).

##### Which act created the Public Company Accounting Oversight Board, which oversees the audits of public companies?

A. The SOX Act of 2002

B. The Securities Act of 1933

C. The Securities Exchange Act of 1934

D. The Companies Act 2006

Answer: A, Taxonomy: Comprehension, Difficulty: Easy, AICPA BB: Governance Perspective, AACSB: Ethics, Learning Objective: LO1.5, Solution: The SOX Act of 2002 created the Public Company Accounting Oversight Board, or PCAOB, which oversees the audits of public companies.

##### The responsibility for creating and grading the Uniform CPA Exam lies with the \_\_\_\_\_\_\_\_.

A. AICPA

B. COSO

C. FASB

D. IAASB

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA BB: Governance Perspective, AACSB: Ethics, Learning Objective: LO1.5, Solution: The AICPA is responsible for creating and grading the Uniform CPA Exam.

##### Which of the following is true of the PCAOB?

A. It can impose punishment on accounting firms that do not adhere to standards.

B. Prior to its creation, the audit profession was highly unregulated.

C. In 2015, it reorganized its auditing standards using several numbering systems.

D. When it was created, it rejected nearly all the then standards of the audit profession.

Answer: A, Taxonomy: Comprehension, Difficulty: Easy, AICPA BB: Governance Perspective, AACSB: Ethics, Learning Objective: LO1.5, Solution: The PCAOB has disciplinary authority over registered firms and can impose punishment on accounting firms that do not adhere to standards. Punishments can include revoking a firm’s registration, monetary fines, and banning an individual from auditing public companies.

##### Which statement is correct as to financial statement audit reports for public versus private companies?

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

B. There is a standard report for the audit of public company financial statements but none for auditing private company financial statements.

C. There is a standard report for the audit of private company financial statements but none for auditing public company financial statements.

D. There is no distinction between standard reports for the audit of financial statements, regardless of whether the company is private or public.

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA FC: Reporting, AACSB: Ethics, Learning Objective: LO1.6, Solution: There is a standard report for the audit of public company financial statements and a standard report for the audit of private company financial statements.

##### In an unqualified audit report on the financial statements of a public company, what does the first statement of the opinion paragraph state?

A. An audit was conducted, which financial statements were audited, and the dates of the financial statements.

B. PCAOB audit standards were followed since it is a public company.

C. The audit firm believes that its audit provides a reasonable basis for its opinion.

D. Management is responsible for the fair presentation of the financial statements.

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA FC: Reporting, AACSB: Ethics, Learning Objective: LO1.6, Solution: In the opinion paragraph, the first sentence explains that an audit was conducted and identifies the financial statements and the dates of the financial statements. The second sentence states the auditor’s opinion.

##### With regard to financial statements, the auditor is required to obtain reasonable assurance, which is a level of assurance that is \_\_\_\_\_\_\_.

A. high, but not absolute

B. guaranteed, but not absolute

C. 100%, but not objective

D. objective, and not subjective

Answer: A, Taxonomy: Comprehension, Difficulty: Easy, AICPA FC: Reporting, AACSB: Ethics, Learning Objective: LO1.6, Solution: The auditor is only required to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error. Reasonable assurance is a high, but not absolute, level of assurance (AU-C 200.06). In other words, the auditor does not “guarantee” or “certify” that the financial statements are 100% accurate because that is considered absolute assurance which is not possible with content that is subjective.

##### When auditors determine that the financial statements of a private firm are presented fairly in accordance with the applicable financial reporting framework, they issue the standard \_\_\_\_\_\_\_ report, which is often referred to as a “\_\_\_\_\_\_\_” report.

A. unmodified, clean

B. qualified, clean

C. modified, rough

D. unqualified, rough

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA FC: Reporting, AACSB: Ethics, Learning Objective: LO1.6, Solution: If auditors have determined the financial statements are presented fairly in accordance with the applicable financial reporting framework, they issue the standard unmodified report. The unmodified report is often referred to as a “clean” report.

##### In an audit report on the effectiveness of ICFR for a public company, what does the scope paragraph explain?

A. The auditors conducted their audit in accordance with the standards of the PCAOB.

B. An internal control system does not eliminate all risk associated with the preparation of financial statements.

C. A material misstatement of the financial statements will not be prevented or detected on a timely basis.

D. Circumstances may change in the future and render controls ineffective if the controls are not modified appropriately.

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA BB: Governance Perspective, AACSB: Communication, Learning Objective: LO1.7, Solution: In an audit report on the effectiveness of ICFR for a public company, the scope paragraph explains that auditors conducted their audit in accordance with the standards of the PCAOB. In brief terms, it explains the process of conducting an audit of the effectiveness of ICFR.

##### In an audit report on the effectiveness of ICFR for a public company, which paragraph cautions not to use the current year opinion to assume that future internal controls will be effective?

A. definition and inherent limitations paragraph

B. scope paragraph

C. opinion paragraph

D. paragraph referencing the financial statement audit

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA BB: Governance Perspective, AACSB: Communication, Learning Objective: LO1.7, Solution: The final sentence of the definition and inherent limitations paragraph cautions not to use the current year opinion to assume that future internal controls will be effective.

##### In an audit report on the effectiveness of ICFR for a public company, what does the definition and inherent limitations paragraph provide?

A. definition of ICFR that is taken directly from PCAOB AS 2201

B. indication that the firm is registered with the PCAOB

C. different responsibilities of management and auditors

D. process of conducting an audit of the effectiveness of ICFR

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA BB: Governance Perspective, AACSB: Communication, Learning Objective: LO1.7, Solution: In an audit report on the effectiveness of ICFR for a public company, the definition and inherent limitations paragraph provides a definition of ICFR that is taken directly from PCAOB AS 2201.

##### In an audit report on the effectiveness of ICFR for a public company, to what does the basis of opinion paragraph make a reference?

A. Registration with the PCAOB and independence requirements of the SEC and other federal securities laws

B. The financial statement audit report and the type of opinion that was given on the financial statements.

C. The COSO Internal Control-Integrated Framework as the criteria used as the basis for determining if ICFR are effective.

D. A definition of ICFR that is taken directly from PCAOB AS 2201.

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA BB: Governance Perspective, AACSB: Communication, Learning Objective: LO1.7, Solution: In an audit report on the effectiveness of ICFR for a public company, the basis for opinion paragraph states the different responsibilities of management and auditors. Like the audit report on the financial statements, this paragraph references registration with the PCAOB and independence requirements of the SEC and other federal securities laws.

##### Which of the following is the discovery of material weakness?

A. conclusion that the company did not maintain effective ICFR over the period under audit.

B. risk that an auditor expresses an inappropriate audit opinion when the financial statements are materially misstated.

C. identification of accounts and related assertions most at risk of material misstatement.

D. high, but not absolute, level of assurance in a judgment about matters that are subjective.

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA BB: Governance Perspective, AACSB: Communication, Learning Objective: LO1.7, Solution: If auditors conclude the company did not maintain effective ICFR over the period under audit, it would mean the auditors discovered a material weakness in the client’s ICFR.

##### If auditors conclude the company did not maintain effective ICFR over the period under audit, it would mean the auditors discovered a/an \_\_\_\_\_\_\_ in the client’s ICFR.

A. material weakness

B. audit risk

C. reasonable assurance

D. professional skepticism

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA BB: Governance Perspective, AACSB: Communication, Learning Objective: LO1.7, Solution: If auditors conclude the company did not maintain effective ICFR over the period under audit, it would mean the auditors discovered a material weakness in the client’s ICFR.

##### Which of the following beliefs will narrow the audit expectation gap?

A. There is no guarantee the auditor will find all material fraud, should fraud have occurred.

B. The auditor is providing complete assurance.

C. The auditor is guaranteeing the future viability of the entity.

D. An unmodified audit opinion is an indicator of complete accuracy of the financial statements.

Answer: A, Taxonomy: Analysis, Difficulty: Easy, AICPA FC: Reporting, AACSB: Communication, Learning Objective: LO1.8, Solution: The audit expectation gap will narrow with the awareness that the auditor will assess the risk of fraud and conduct tests to try to uncover any fraud, but there is no guarantee the auditor will find all material fraud, should one have occurred.

##### Economic conditions impact \_\_\_\_\_\_\_.

A. financial statement user’s expectations

B. auditor performance

C. both financial statement user’s expectations and auditor performance

D. neither financial statement user’s expectations not auditor performance

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA FC: Reporting, AACSB: Communication, Learning Objective: LO1.8, Solution: The economic conditions impact financial statement user’s expectations.

##### Legislation impacts \_\_\_\_\_\_\_.

A. auditor performance

B. financial statement user’s expectations

C. both financial statement user’s expectations and auditor performance

D. neither financial statement user’s expectations not auditor performance

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA BB: Governance Perspective, AACSB: Communication, Learning Objective: LO1.8, Solution: Legislation impacts auditor performance.

##### Education of financial statement users as to the responsibilities of preparers and auditors of financial statements will \_\_\_\_\_\_\_\_\_.

A. reduce the audit expectation gap

B. ensure the auditor will find all material fraud

C. guarantee the future viability of the entity

D. increase audit firm reputation and independence

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA FC: Reporting, AACSB: Communication, Learning Objective: LO1.8, Solution: Education of financial statement users as to the responsibilities of preparers and auditors of financial statements will reduce the audit expectation gap.

##### The audit expectation gap is narrowed by realistic user expectations such as that the auditor \_\_\_\_\_\_\_\_.

A. tests a sample of transactions

B. is providing complete assurance

C. is guaranteeing the future viability of the entity

D. will definitely find any and all fraud

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA FC: Reporting, AACSB: Communication, Learning Objective: LO1.8, Solution: One of the many realistic expectations that we must have of auditors is that the auditor does not check all transactions but only a sample of transactions.

##### The audit expectation gap occurs when there is a difference between the expectations of the \_\_\_\_\_\_\_\_.

A. auditors and financial statement users

B. auditors and company under review

C. company under review and financial statement users

D. generally accepted accounting principles and auditors

Answer: A, Taxonomy: Knowledge, Difficulty: Easy, AICPA FC: Reporting, AACSB: Communication, Learning Objective: LO1.8, Solution: The audit expectation gap occurs when there is a difference between the expectations of auditors and financial statement users.

#### Question Type: Text Entry

##### In the context of auditing and assurance standards, \_\_\_\_\_\_\_are the most specific and narrow.

A. Audit services | Assurance services

Answer: Audit services, Taxonomy: Knowledge, Difficulty: Easy, AICPA FC: Reporting, AACSB: Communication, Learning Objective: LO1.1, Solution: The relationship of assurance, attestation, and auditing services resembles overlapping umbrellas. Audit services are the most specific and narrow of the three services.

##### As attestation services encompass more than just the inspection of historical financial statements, the term \_\_\_\_\_\_\_ is used rather than \_\_\_\_\_\_\_.

A. practitioner

B. auditor

Answer: N/A, Taxonomy: Knowledge, Difficulty: Easy, AICPA FC: Measurement Analysis and Interpretation, AACSB: Ethics, Learning Objective: LO1.1, Solution: In attestation services, the term practitioner is used rather than auditor because attestation services encompass more than just the audit of historical financial statements.

##### Website security and IT operations are services that come under \_\_\_\_\_\_\_ services but fall outside \_\_\_\_\_\_\_ services.

A. assurance

B. attestation

Answer: N/A, Taxonomy: Knowledge, Difficulty: Easy, AICPA FC: Measurement Analysis and Interpretation, AACSB: Ethics, Learning Objective: LO1.1, Solution: Assurance services include compilation of historical statements, website security, IT operations, and non-financial information. Attestation services (under the umbrella of assurance services) include review of historical financial statements, review of financial forecast, and examination of internal control.

##### \_\_\_\_\_\_\_is an assurance service but not an attestation service.

review of historical financial statements | compilation of non-financial information | examination of internal control | review of a financial forecast

Answer: Compilation of non-financial information, Taxonomy: Knowledge, Difficulty: Easy, AICPA FC: Measurement Analysis and Interpretation, AACSB: Ethics, Learning Objective: LO1.1, Solution: Assurance services include compilation of non-financial information, historical statements, website security, and IT operations.

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

material

Answer: N/A, Taxonomy: Knowledge, Difficulty: Easy, AICPA FC: Measurement Analysis and Interpretation, AACSB: Ethics, Learning Objective: LO1.2, Solution: The Financial Accounting Standards Board (FASB) defines materiality as follows: Information is material if omitting it or misstating it could influence decisions that users make on the basis of the financial information of a specific reporting entity. (SFAC No. 8, para QC11)

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

compliance audit

Answer: N/A, Taxonomy: Comprehension, Difficulty: Easy, AICPA FC: Measurement Analysis and Interpretation, AACSB: Ethics, Learning Objective: LO1.2, Solution: One of the best examples of a compliance audit is an income tax audit. The Internal Revenue Service (IRS) may conduct an audit of an individual or a company to determine if tax laws have been followed and the correct amount of tax paid.

##### \_\_\_\_\_\_\_ are users of financial statements who are particularly interested in the capacity of the company to pay a dividend

Investors

Answer: N/A, Taxonomy: Knowledge, Difficulty: Easy, AICPA FC: Measurement Analysis and Interpretation, AACSB: Analytic, Learning Objective: LO1.3, Solution: Investors generally read financial statements to determine whether they should invest in the company. They are interested in the return on their investment and are concerned that the entity will remain a going concern (continue operating) into the foreseeable future. Investors may also be interested in the capacity of the company to pay a dividend. Prospective investors read financial statements to determine whether they should buy shares in the entity.

##### \_\_\_\_\_\_\_ are users of financial statements who are particularly interested in determining whether the company is sufficiently credit worthy.

Lenders

Answer: N/A, Taxonomy: Knowledge, Difficulty: Easy, AICPA FC: Measurement Analysis and Interpretation, AACSB: Analytic, Learning Objective: LO1.3, Solution: Lenders may read financial statements to determine whether an entity is sufficiently credit worthy to make a loan to the entity and whether it can pay the interest and principal as they come due.

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

Professional judgment

Answer: N/A, Taxonomy: Knowledge, Difficulty: Easy, AICPA FC: Measurement Analysis and Interpretation, AACSB: Analytic, Learning Objective: LO1.4, Solution: Professional judgment relates to the application of relevant training, knowledge, and experience that auditors use while making informed audit decisions in conducting an audit. Auditors must use their judgment throughout the entire audit. For example, auditors must use judgment when determining if an information source is reliable. They must also use judgment when deciding if enough audit evidence has been gathered to support the audit opinion.

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

Professional skepticism

Answer: N/A, Taxonomy: Knowledge, Difficulty: Easy, AICPA FC: Measurement Analysis and Interpretation, AACSB: Analytic, Learning Objective: LO1.4, Solution: Professional skepticism means the auditors remain independent of the entity, its management and its staff when completing the audit work. In a practical sense, it means the auditors maintain a questioning mind and thoroughly investigate all evidence presented by their client.

##### The accounting firm CBIZ/Mayer Hoffman McCann PC is one of the \_\_\_\_\_\_\_\_ firms.

mid-tier

Answer: N/A, Taxonomy: Knowledge, Difficulty: Easy, AICPA: Customer Perspective, AACSB: Analytic, Learning Objective: LO1.4, Solution: Below the Big 4, the next tier of accounting firms is known as the mid-tier. The firms that comprise the mid-tier have a significant presence nationally and most have international affiliations. The mid-tier firms in the U.S. include, among others, Grant Thornton LLP, BDO USA LLP, RSM LLP, CBIZ/Mayer Hoffman McCann PC, and CroweHorwath LLC. These firms service medium-sized and smaller clients.

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

introductory

Answer: N/A, Taxonomy: Knowledge, Difficulty: Easy, AICPA FC: Reporting, AACSB: Ethics, Learning Objective: LO1.6, Solution: The introductory paragraph of an unmodified audit report on the financial statements explains that an audit was conducted and identifies the financial statements and the date of the financial statements.

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

Opinion

Answer: N/A, Taxonomy: Knowledge, Difficulty: Easy, AICPA FC: Reporting, AACSB: Ethics, Learning Objective: LO1.6, Solution: In an unmodified audit report on the financial statements of a private firm, the opinion paragraph clearly states the auditor’s opinion that the financial statements are fairly presented, in all material respects, in accordance with the applicable financial reporting framework.

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

independent

Answer: N/A, Taxonomy: Knowledge, Difficulty: Easy, AICPA BB: Governance Perspective, AACSB: Communication, Learning Objective: LO1.7, Solution: In the title of an audit report on the effectiveness of ICFR for a public company, the term “independent” emphasizes that the auditors are external to the company and therefore can provide an objective opinion.

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

title

Answer: N/A, Taxonomy: Knowledge, Difficulty: Easy, AICPA BB: Governance Perspective, AACSB: Ethics, Learning Objective: LO1.7, Solution: In the title of an audit report on the effectiveness of ICFR for a public company, the term “registered” is required to indicate that the firm is registered with the PCAOB.

##### One of the factors that impacts auditor performance is \_\_\_\_\_\_\_.

audit standards, ethical standards, regulations, legislation, or firm policy and procedures.

Answer: N/A, Taxonomy: Knowledge, Difficulty: Easy, AICPA FC: Measurement Analysis and Interpretation, AACSB: Communication, Learning Objective: LO1.8, Solution: Auditor performance is impacted by audit standards, ethical standards, regulations, legislation, and firm policy and procedures.

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

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

Answer: N/A, Taxonomy: Knowledge, Difficulty: Medium, AICPA FC: Measurement Analysis and Interpretation, AACSB: Analytic, Learning Objective: LO1.1,

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

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

Answer: N/A, Taxonomy: Knowledge, Difficulty: Medium, AICPA FC: Reporting, AACSB: Analytic, Learning Objective: LO1.1,

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

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

Answer: N/A, Taxonomy: Knowledge, Difficulty: Easy, AICPA FC: Measurement Analysis and Interpretation, AACSB: Analytic, Learning Objective: LO1.1,

#### Question Type: Short Answer

##### Briefly describe the focus of each of the following professional engagements:

1- Auditing Engagement

2- Attestation Engagement

3 - Assurance Engagement

A. 1- Auditing Engagement - financial statements

2- Attestation Engagement - financial information about the entity

3 - Assurance Engagement - any information as requested by the entity

Answer: N/A, Taxonomy: Analysis, Difficulty: Medium, AICPA FC: Research, AACSB: Analytic, Learning Objective: LO1.2,

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

Answer: N/A, Taxonomy: Synthesis, Difficulty: Hard, AICPA BB: Governance Perspective, AACSB: Reflective Thinking, Learning Objective: LO1.6,

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

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

**Auditor's Report**

To the creditors of Gawronski's Hockey Manufacturing Company:

**Report on the Financial Statements**

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

Answer: N/A, Taxonomy: Evaluation, Difficulty: Hard, AICPA FC: Reporting, AACSB: Analytic, Learning Objective: LO1.6,

Solution: [1] Title – the term independent is missing in the title of the report

[2] Address – The report is addressed to the creditors of the company rather than the owners or shareholders of the company and to the board of directors, if applicable.

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

**Auditor’s Responsibility**

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with generally accepted accounting principles. Those standards require that we plan and perform the audit to obtain absolute assurance about whether the financial statements are free from material misstatement.

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

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Answer: N/A, Taxonomy: Evaluation, Difficulty: Hard, AICPA FC: Reporting, AACSB: Analytic, Learning Objective: LO1.6,

Solution: Both errors are in the first paragraph

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with **auditing standards generally accepted in the United States of America.** Those standards require that we plan and perform the audit to obtain **absolute** assurance about whether the financial statements are free from material misstatement.

1) The appropriate audit standards would be those issued by the ASB since the company is a private company.

2) Audits provide reasonable assurance, not absolute.

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

**Opinion**

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

Keith Christy, Partner

Adrian, Michigan

February 15, 2023

Answer: N/A, Taxonomy: Evaluation, Difficulty: Hard, AICPA FC: Reporting, AACSB: Analytic, Learning Objective: LO1.6,

Solution: **Opinion**

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Gawronski's Hockey Manufacturing Company as of December 31, 2022 and 2021, and the results of its operations and its cash flows for the years then ended in accordance with **accounting principles** generally accepted in the United States of America.

**Christy and Quinlan, LLP**

February 15, 2023

1) The financial statements are in accordance with GAAP, not GAAS

2) The firm name is used in the signature, not the individual partner's name

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

Answer: N/A, Taxonomy: Evaluation, Difficulty: Hard, AICPA FC: Reporting, AACSB: Analytic, Learning Objective: LO1.6 Explain the concept of reasonable assurance, materiality, and the nature of an unqualified/unmodified report on the audit of financial statements.

Solution: Some differences that may be noted include:

Title -The term registered is included to emphasize the firm is registered with the PCAOB.

Paragraph order - The opinion paragraph comes at the beginning of the report, along with other differences in the order of paragraphs

Paragraph referencing the audit of internal control – This paragraph is unique to the public company audit report. Public companies are required to have an audit of ICFR and auditors issue a separate opinion for that audit, which is discussed in the next section.

Basis for opinion paragraph –The private company report goes into more detail regarding the responsibilities of management and auditors. One key difference is this paragraph references registration with the PCAOB and independence requirements of the SEC and other federal securities laws.

Scope paragraph - It includes an explicit statement that PCAOB audit standards were followed since it is a public company.

Auditor tenure – The final component of the report is a sentence that states the year in which the firm began serving consecutively as the company’s auditor.

##### Describe the auditor’s responsibility regarding the detection of fraud.

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

Answer: N/A, Taxonomy: Knowledge, Difficulty: Medium, AICPA: Risk Assessment, Analysis and Management, AACSB: Ethics, Learning Objective: LO1.6 Explain the concept of reasonable assurance, materiality, and the nature of an unqualified/unmodified report on the audit of financial statements.

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

Answer: N/A, Taxonomy: Evaluation, Difficulty: Hard, AICPA FC: Reporting, AACSB: Analytic, Learning Objective: LO1.7,

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

##### Smith Corp. orally engaged TRA CPAs, to audit its financial statements. The management of Smith Corp. informed TRA CPAs that it suspected that the accounts receivable was materially overstated. Although the financial statements audited by TRA CPAs did, in fact, include a materially overstated accounts receivable balance, TRA issued an unqualified opinion. Smith Corp then relied on the financial statements in deciding to obtain a loan from Town Bank to expand its operations and Town Bank relied on the financial statements in making the loan to Smith Corp. As a result of the overstated accounts receivable balance, Smith Corp. has defaulted on the loan and has incurred a substantial loss. If Smith Corp sues TRA CPAs for negligence in failing to discover the overstatement, what is TRA CPA's best defense?

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

Answer: N/A, Taxonomy: Knowledge, Difficulty: Hard, AICPA FC: Measurement Analysis and Interpretation, AACSB: Ethics, Learning Objective: LO1.7,

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

Answer: N/A, Taxonomy: Synthesis, Difficulty: Hard, AICPA FC: Reporting, AACSB: Analytic, Learning Objective: LO1.8,

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

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

The reality is that:

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

The audit expectation gap can be reduced by:

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