***Auditing and Assurance Services, 15e* (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 publicly 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 publicly traded audit clients. Which of the following is true for auditors of publicly 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. Many states prohibit CPA firms from organizing as a general 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 similar to that 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 accounting firms 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 publicly traded audit clients.
A) True
B) False
Answer: A
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) performs inspections of the quality controls of audit firms that audit public companies.
B) establishes auditing standards that must be followed by CPAs on all audits.
C) oversees auditors of private companies.
D) performs 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?
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.
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 publicly 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 SEC, an agency of the federal government , assists in providing investors with reliable information upon which to make investment decisions. The SEC has considerable influence in setting generally accepted accounting principles and disclosure requirements for financial statements as a result of its authority for specifying reporting requirements considered necessary for fair disclosure to investors. The SEC has power to establish rules for any CPA associated with audited financial statements submitted to the commission. The SEC's attitude is generally considered in any major change proposed by the FASB, the independent organization that establishes U.S. GAAP.
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) 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

3) 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

4) 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

5) 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 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 International Standards on Auditing (ISAs):
A) are issued by the AICPA.
B) override a country's regulations governing the audit of a company.
C) has many of the same standards as the Auditing Standards Board (ASB).
D) must be followed by companies whose stock is traded in the U.S.
Answer: C
Terms: International Standards on Auditing; International Auditing and Assurance Standards Board
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) Which of the following is a true statement regarding auditing standards?
A) Prior to the passage of Sarbanes-Oxley, the FASB established auditing principles for U.S. public companies.
B) PCAOB auditing standards are applicable to entities outside the U.S.
C) There are no similarities between PCAOB standards and International Standards on Auditing.
D) The Auditing Standards Board has revised most of its standards to converge with the international standards.
Answer: D
Terms: Auditing standards of United States and International Standards of Auditing
Diff: Easy
Objective: LO 2-5
AACSB: Reflective thinking skills

7) The PCAOB considers International Standards on Auditing (ISAs) when developing its standards.
A) True
B) False
Answer: A
Terms: Public Company Accounting Oversight Board Standards
Diff: Easy
Objective: LO 2-5
AACSB: Reflective thinking skills
Topic: SOX

8) International Standards on Auditing are issued by the International Auditing and Assurance Standards Board.
A) True
B) False
Answer: A
Terms: International Standards on Auditing; International Auditing and Assurance Standards Board
Diff: Easy
Objective: LO 2-5
AACSB: Reflective thinking skills

Learning Objective 2-6

1) Historically auditing standards have been organized into three categories, including:
A) Standards of field work.
B) Purpose of an audit.
C) Responsibilities of the auditor.
D) Proper planning and supervision.
Answer: A
Terms: GAAS, general standards
Diff: Easy
Objective: LO 2-6
AACSB: Reflective thinking skills

2) The "Principles Underlying an Audit in Accordance with Generally Accepted Auditing Principles" provides a framework to help auditors:
A) understand the ten GAAS standards.
B) obtain complete assurance that the financial statements are free from any error.
C) report on the financial statements.
D) prevent fraud.
Answer: C
Terms: GAAS; New principles underlying GAAS
Diff: Easy
Objective: LO 2-6
AACSB: Reflective thinking skills

3) Which of the following is **not** one of the responsibilities of an auditor under the principles underlying an audit?
A) Possess appropriate competence and capabilities
B) Comply with ethical requirements
C) Plan work and supervise assistants
D) Maintain professional skepticism and exercise professional judgment
Answer: C
Terms: New principles underlying an audit
Diff: Easy
Objective: LO 2-6
AACSB: Reflective thinking skills

4) To obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, the auditor must fulfill several performance responsibilities, including:
A) verifying that all audit work is performed by a CPA with a minimum of three years experience.
B) obtaining sufficient, appropriate audit evidence.
C) exercising professional judgment.
D) providing an opinion on the financial statements.
Answer: B
Terms: GAAS- New principles underlying GAAS; Purpose of an audit
Diff: Easy
Objective: LO 2-6
AACSB: Reflective thinking skills

5) The Statements on Auditing Standards issued by the Auditing Standards Board:
A) are regarded as authoritative literature.
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: General accepted auditing standards; Performance
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) When assessing the risk of material misstatements in the financial statements,
A) inadequate internal control procedures will mitigate client business risk.
B) GAAS specifies in detail how much and what types of evidence the auditor needs to obtain.
C) company management is responsible for determining materiality levels.
D) the auditor must have an understanding of the client's business and industry.
Answer: D
Terms: General accepted auditing standards; Performance
Diff: Moderate
Objective: LO 2-6
AACSB: Reflective thinking skills

8) In order to properly plan and perform an audit, an important fact for both the auditor and the client to understand is that:
A) the internal control policies and procedures are developed by the auditors.
B) the purpose of an audit is to prevent fraud.
C) management is responsible for the preparation of the financial statements.
D) management can restrict the auditor's access to important information relevant to the financial statements.
Answer: C
Terms: GAAS- New principles underlying GAAS; Purpose of an audit
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: Moderate
Objective: LO 2-6
AACSB: Reflective thinking skills

14) List the four principles underlying an audit.
Answer:
- Purpose of an audit
- Responsibilities
- Performance
- Reporting

Terms: GAAS; New principles underlying GAAS
Diff: Easy
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) Professional skepticism must be maintained only if the auditor suspects fraud.
A) True
B) False
Answer: B
Terms: Generally Accepted Auditing Standards; Responsibilities
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) The SAS number identifies the order in which it was issued in relation to all other SASs.
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 publicly 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-publicly 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 publicly traded companies
Diff: Moderate
Objective: LO 2-7
AACSB: Reflective thinking skills

2) The methods used by a CPA firm to ensure that the firm meets is professional responsibilities to clients and others is:
A) continuing professional education.
B) compliance with generally accepted reporting standards.
C) quality control.
D) peer review.
Answer: C
Terms: Quality control policies and procedures
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 a client 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 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 2-7
AACSB: Reflective thinking skills

7) 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

8) 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

9) 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 a culture that quality is essential in performing engagements and should establish policies and procedures that support that culture.
- *Relevant ethical requirements* - Personnel on engagements 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 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

10) 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.

Audit firm Policy or Procedure	Standards Category
1. Determination on whether to accept or reject a new client.	a. GAAS
2. A client evaluation form.	b. Quality Control
3. All personnel participate in continuing professional education.	
4. Conducting the audit with professional skepticism.	
5. Answering an independence questionnaire.	
6. Determine and apply materiality levels.	
7. Audit staff workpapers are reviewed by audit seniors, then managers.	
8. Plan work and supervise assistants.	

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

11) 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.

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

12) 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