

Chapter 2

Multiple-Choice Questions

1. Which one of the following is not one of the three General Standards?
easy
a a. Proper planning and supervision.
 b. Independence of mental attitude.
 c. Adequate training and proficiency.
 d. Due professional care.

2. Which one of the following is not a Field Work Standard?
easy
b a. Adequate planning and supervision.
 b. Due professional care.
 c. Understand the entity and its environment including internal control.
 d. Sufficient appropriate audit evidence.

3. The General Standards stress the importance of:
easy
b a. evidence accumulation.
 b. personal qualities the auditor should possess.
 c. communicating the auditor's findings to the reader.
 d. general supervision of the audit.

4. The generally accepted auditing standard that requires "Adequate technical training and proficiency" is normally interpreted as requiring the auditor to have:
easy
a a. formal education in auditing and accounting.
 b. worked for an entity similar to the entity being audited.
 c. independence in mental attitude
 d. a graduate degree in a business field.

5. (SOX) Members of the Public Company Accounting Oversight Board are appointed and overseen by:
easy
d a. the U.S. Congress.
 b. the American Institute of Certified Public Accountants.
 c. the Auditing Standards Board.
 d. the Securities and Exchange Commission.

6. Statements on Auditing Standards provide auditors of privately held companies with _____ guidance regarding the conduct of financial statement audits.
easy
b a. fairly extensive
 b. some limited
 c. practically no
 d. specific and detailed

7. easy
c Which of the following statements most accurately captures the intent of the standards of field work?
- Field work standards are primarily concerned with personal attributes necessary during the conduct of the audit.
 - Field work standards provide extensive guidance regarding the conduct of an audit.
 - Field work standards are primarily directed at the auditor's planning, understanding of internal control, and evidence accumulation.
 - Field work standards are primarily concerned with the conduct of substantive testing as opposed to testing of internal controls.
8. (SOX) easy
c Prior to the passage of the Sarbanes-Oxley Act, which of the following was responsible for establishing auditing standards?
- Securities and Exchange Commission
 - Public Company Accounting Oversight Board
 - Auditing Standards Board
 - National Association of Accounting
9. (SOX) medium
b Standards issued by the Public Company Accounting Oversight Board must be followed by CPAs who audit:
- both private and public companies.
 - public companies only.
 - private companies, public companies, and nonprofit entities.
 - private companies only.
10. medium
b Which of the following is the least likely form of business for a CPA firm?
- General partnership
 - General corporation
 - Limited liability company
 - Limited liability partnership
11. medium
a The Statements on Auditing Standards issued by the Auditing Standards Board:
- are interpretations of generally accepted auditing standards.
 - are the equivalent of laws for audit practitioners.
 - must be followed in all situations.
 - are optional guidelines which an auditor may choose to follow or not follow when conducting an audit.
12. medium
a An auditor need not abide by a particular auditing standard if the auditor believes that:
- the issue in question is immaterial in amount.
 - more expertise is needed to fulfill the requirement.
 - the requirement of the standard has not been addressed by the PCAOB.
 - any of the above three are correct.
13. (SOX) medium
b The Public Company Accounting Oversight Board does not:
- perform inspections of the quality controls at audit firms that audit public companies.
 - establish auditing standards that must be followed by CPAs on all audits.
 - oversee auditors of public companies.
 - perform any of the above functions.
14. medium
b 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:
- Form S-1.
 - Form 8-K.
 - Form 10-K.

- d. Form 10-Q.
15.
medium
a 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.
16.
medium
c The third general standard states that due care is to be exercised in the performance of an audit. This standard is generally interpreted to require:
a. objective review of the adequacy of the technical training of firm personnel.
b. thorough review of the existing internal control structure.
c. critical review of work done at every level of supervision.
d. periodic review of a CPA firm's quality control procedures.
17. (SOX)
medium
d Assume the Public Company Accounting Oversight Board (PCAOB) identifies a violation during its inspection of a registered accounting firm.
a. The PCAOB may not enforce some disciplinary action against the accounting firm.
b. The PCAOB may not report the matter to the Securities and Exchange Commission.
c. The PCAOB may not report the matter to the appropriate state accountancy board.
d. The PCAOB may not suspend the license to practice of the CPA guilty of the violation.
18.
medium
d 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."
19.
medium
a 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.
20.
medium
c Consulting Standards are issued by the:
a. Accounting and Review Services Committee.
b. Securities and Exchange Commission.
c. Management Consulting Services Executive Committee.
d. Financial Accounting Standards Board.
21.
medium
d The auditor's judgment concerning the overall fairness of presentation of financial position, results of operations, and changes in cash flow is applied within the framework of:
a. quality control.
b. generally accepted auditing standards which include the concept of materiality.
c. the auditor's evaluation of the audited company's internal control.
d. generally accepted accounting principles.
22.
medium
c A basic objective of a CPA firm is to provide professional services to conform to professional standards. Reasonable assurance of achieving this basic objective is provided through:
a. continuing professional education.

- b. compliance with generally accepted reporting standards.
 - c. a system of quality control.
 - d. a system of peer review.

- 23.
medium
c

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.

- 24.
medium
d

Williams & Co., a member of the Private Companies Practice Section, is to have a “peer review.” The peer review can be performed by:

 - a. a CPA firm selected by Williams & Co.
 - b. a review team selected by the state society.
 - c. internal auditors.
 - d. either a or b.

- 25.
medium
a

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.

- 26.
medium
a

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.

- 27.
challenging
c

Which of the following is true regarding the AICPA-approved practice monitoring programs?

 - a. The Center for Public Company Audit Firms does not offer a peer review program.
 - b. Firms registered with the PCAOB must not enroll in an AICPA-approved practice monitoring program.
 - c. Public accounting firms must be enrolled in an AICPA-approved practice monitoring program for members in the firm to be eligible for membership in the AICPA.
 - d. The AICPA peer review program is administered through the SEC.

- 28.
challenging
c

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.

- 29. (SOX)
challenging
a

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*.

30. challenging a The SEC requirements of greatest interest to CPAs are set forth in the SEC's:
- Regulation S-X and Accounting Series Releases.
 - S-1 through S-16 forms.
 - Director's newsletter.
 - Forms 8-K, 10-K, and 10-Q.
31. challenging d The AICPA has authority to establish standards and rules in all but which of the following areas?
- Auditing standards applicable to financial statements of private companies.
 - Compilation and review standards.
 - Professional conduct.
 - Auditing standards applicable to financial statements of private and public companies.
32. challenging c Generally Accepted Auditing Standards (GAAS) and Statements on Auditing Standards (SAS) should be looked upon by practitioners as:
- ideals to work towards, but which are not achievable.
 - maximum standards that denote excellent work.
 - minimum standards of performance that must be achieved on each audit engagement.
 - benchmarks to be used on all audits, reviews, and compilations.
33. challenging c Which one of the following is not a requirement for belonging to the Private Companies Practice Section of the American Institute of Certified Public Accountants?
- Adherence to quality control standards.
 - Mandatory peer review.
 - Partner rotation after a period of ten consecutive years.
 - Continuing education.
34. challenging b Statements on Auditing Standards issued by the AICPA's Auditing Standards Board are:
- part of the generally accepted auditing standards under the AICPA *Code of Professional Conduct*.
 - interpretations of generally accepted auditing standards and departures from such statements must be justified.
 - interpretations of generally accepted auditing standards and such standards must be followed in every engagement.
 - generally accepted auditing procedures that are not covered by the AICPA *Code of Professional Conduct*.

Essay Questions

35. easy 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. 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.

36. Discuss the relationship between quality control and generally accepted auditing standards.
easy

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. A CPA firm must make sure that GAAS are followed on every audit. Quality controls are the procedures used by the CPA firm that help it meet requirements demanded by GAAS on every engagement in a consistent manner.

37. Describe the various staff levels and responsibilities of a typical public accounting firm.
easy

Answer:

- *Staff assistant* - Staff assistants, or staff accountants, perform most of the detailed audit work.
- *Senior or In-charge auditor* - Seniors coordinate and are responsible for the audit field work, including the supervision and review of staff assistants' work.
- *Manager* - Managers assist the senior plan and manage the audit, review the senior's work, and manages relations with the client. A manager may be responsible for multiple engagements at the same time.
- *Partner* - Partners review the overall audit work and they are involved in all significant audit decisions. As owners of the firm, partners are ultimately responsible for conducting the audit and serving the client.

38. Discuss the five elements of quality control. Who establishes the standards for quality control?
medium

Answer:

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

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

39. Describe the six organizational structures available to CPA firms.
medium

Answer:

CPA firms can take one of six organizational forms:

- *Proprietorship*. This form is limited to firms with only one owner.
- *General partnership*. This form is similar to a proprietorship, except that it applies to multiple owners.

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

40.
medium

There are ten generally accepted auditing standards, divided into three categories. List, by category, each of these ten standards.

Answer:

General Standards

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

Standards of Fieldwork

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

Standards of Reporting

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

41.
medium

In the context of auditing, explain what is meant by an independent mental attitude. Discuss how internal auditors can have an independent mental attitude when they are employed by the company they audit.

Answer:

Independent mental attitude refers to a state of mind in which the CPA is totally unbiased with respect to the client and the financial information under audit.

Although internal auditors are employees of the organization for which their audits are performed, internal auditors should be independent of the function being examined and should report their findings to a level high enough in the organization to allow the auditor to be free from influence by the party, or parties, being examined.

42. (SOX)
medium

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

Answer:

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

43.
challenging

What are four of 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. 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.
- Developing specialist certifications.
- Writing and grading the uniform CPA examination.
- Providing continuing education seminars for its members.

44.
challenging

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

Answer:

The overall purpose of the SEC is to assist in providing investors with reliable information upon which to make investment decisions. As a result of its authority for specifying financial reporting requirements, the SEC has considerable influence in setting generally accepted accounting principles. Although the SEC has taken the position that accounting principles should be set by the profession (FASB), the SEC's opinion is generally considered in any major change in GAAP proposed by the FASB.

45.
challenging

The purpose of the AICPA's CPA Vision Project is to help CPAs make sense of our changing and complex world. The Project has identified core values that CPAs must be aware of in the future. What are the top five core values?

Answer:

- Continuing education and lifelong learning
- Competence
- Integrity
- Attuned to broad business issues
- Objectivity

Other Objective Answer Format Questions

46.
easy
b

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

- b. False
47. Membership in the AICPA is mandatory for all licensed practicing CPAs.
easy
b a. True
b. False
48. Any public accounting firm can be a member of the AICPA if the firm meets the membership requirements.
easy
a a. True
b. False
49. Statements on Auditing Standards (SASs) are issued by the Public Company Accounting Oversight Board.
easy
b a. True
b. False
50. (SOX) Auditors of public companies should, in the absence of guidance issued by the PCAOB, follow auditing standards issued by the SEC.
easy
b a. True
b. False
51. (SOX) The U.S. Congress has oversight responsibility for the PCAOB.
medium
b a. True
b. False
52. Form 10-K must be filed with the SEC whenever a public company experiences a significant event.
medium
b a. True
b. False
53. In a limited liability partnership, partners are personally liable for liabilities arising from negligent acts of other partners, but not for liabilities arising from acts of other employees.
medium
b a. True
b. False
54. 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.
medium
a a. True
b. False
55. (SOX) All CPA firms registered with the PCAOB are required to undergo a peer review at least once every two years.
medium
b a. True
b. False
56. Statements on Auditing Standards (SASs) are considered to be interpretations of the ten generally accepted auditing standards.
medium
a a. True
b. False
57. (SOX) Any CPA firm that audits more than 100 public companies is required to have an annual inspection by the PCAOB.
medium
a a. True
b. False
58. The overall purpose of the Securities and Exchange Commission is to assist in providing

medium
a

investors with reliable information upon which to make investment decisions.
a. True
b. False

59.
medium
a

International Standards on Auditing are issued by the International Auditing Practices Committee.
a. True
b. False