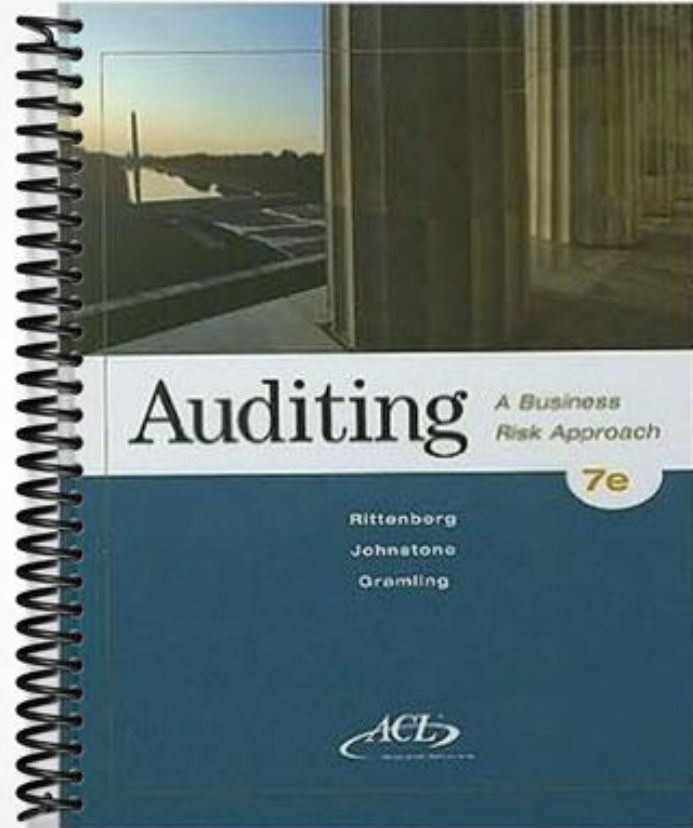


TEST BANK



Auditing *A Business Risk Approach*

7e

Rittenberg
Johnstone
Gramling



Chapter 2: Corporate Governance and Audits

TRUE/FALSE

1. The objective of financial reporting is to provide useful information to interested users.
ANS: T PTS: 1 OBJ: Corporate Governance and Auditing
NAT: AACSB-Analytical thinking | AICPA BB-Critical thinking
2. Corporate governance is a process by which the owners, but not the creditors, exert control over the resources of the enterprise.
ANS: F PTS: 1 OBJ: Corporate Governance and Auditing
NAT: AACSB-Analytical thinking | AICPA BB-Critical thinking
3. The development of strategic plans for a business entity is the responsibility of the board of directors.
ANS: F PTS: 1 OBJ: Corporate Governance and Auditing
NAT: AACSB-Analytical thinking | AICPA BB-Critical thinking
4. The audit committee is a subcommittee of the board of directors comprised of independent outside directors.
ANS: T PTS: 1 OBJ: Enhanced Role of Audit Committees
NAT: AACSB-Analytical thinking | AICPA BB-Critical thinking
5. The auditor must communicate significant audit adjustments to the audit committee.
ANS: T PTS: 1
OBJ: Required Audit Firm Communication to the Audit Committee
NAT: AACSB-Analytical thinking | AICPA BB-Critical thinking
6. Any major disagreement the auditor has with management should be discussed with the audit committee.
ANS: T PTS: 1
OBJ: Required Audit Firm Communication to the Audit Committee
NAT: AACSB-Analytical thinking | AICPA BB-Critical thinking
7. An audit must be performed by persons who can make sound judgment relating to complex accounting issues.
ANS: T PTS: 1
OBJ: Generally Accepted Auditing Standards and IAASB Principles
NAT: AACSB-Analytical thinking | AICPA BB-Critical thinking
8. Managers of organizations are hired by Boards of Directors to perform responsibilities such as the implementation of internal control.
ANS: T PTS: 1 OBJ: Corporate Responsibility for Financial Reporting
NAT: AACSB-Analytical thinking | AICPA BB-Critical thinking

9. The auditor must, at a minimum, follow Generally Accepted Auditing Standards to perform an audit with due professional care.

ANS: T PTS: 1

OBJ: Generally Accepted Auditing Standards and IAASB Principles

NAT: AACSB-Analytical thinking | AICPA BB-Critical thinking

10. Generally Accepted Auditing Standards encompass three broad categories including: general standards, fieldwork standards and reporting standards.

ANS: T PTS: 1

OBJ: Generally Accepted Auditing Standards and IAASB Principles

NAT: AACSB-Analytical thinking | AICPA BB-Critical thinking

11. The general auditing standards are designed to guide the profession in the selection and training of its professionals, performance of duties, and in maintaining an adequate separation from the client to meet the public trust.

ANS: T PTS: 1

OBJ: Generally Accepted Auditing Standards and IAASB Principles

NAT: AACSB-Analytical thinking | AICPA BB-Critical thinking

12. GAAS requires technical knowledge in auditing but not in the client's business.

ANS: F PTS: 1

OBJ: Generally Accepted Auditing Standards and IAASB Principles

NAT: AACSB-Analytical thinking | AICPA BB-Critical thinking

13. Generally accepted auditing standards are the cornerstone for the interpretation of financial accounting.

ANS: F PTS: 1

OBJ: Generally Accepted Auditing Standards and IAASB Principles

NAT: AACSB-Analytical thinking | AICPA BB-Critical thinking

14. The reporting standard of GAAS includes consistency, disclosure, and due professional care.

ANS: F PTS: 1

OBJ: Generally Accepted Auditing Standards and IAASB Principles

NAT: AACSB-Analytical thinking | AICPA BB-Critical thinking

15. An auditor must be independent in fact and in appearance.

ANS: T PTS: 1

OBJ: Generally Accepted Auditing Standards and IAASB Principles

NAT: AACSB-Analytical thinking | AICPA BB-Critical thinking

16. Without independence, the value of the auditor's attestation function would be nil.

ANS: T PTS: 1

OBJ: Generally Accepted Auditing Standards and IAASB Principles

NAT: AACSB-Analytical thinking | AICPA BB-Critical thinking

17. Due professional care is defined as following Generally Accepted Accounting Standards.

ANS: F PTS: 1
OBJ: Generally Accepted Auditing Standards and IAASB Principles
NAT: AACSB-Analytical thinking | AICPA BB-Critical thinking

18. Public accounting firms use close supervision and review of audit work to ensure that audits are conducted with due professional care.

ANS: T PTS: 1
OBJ: Generally Accepted Auditing Standards and IAASB Principles
NAT: AACSB-Analytical thinking | AICPA BB-Critical thinking

19. The process of understanding the client includes the preparation of the audit program.

ANS: T PTS: 1
OBJ: Overview of the Audit Process: A Standards-Based Approach
NAT: AACSB-Analytical thinking | AICPA BB-Critical thinking

20. Part of the understanding the client process of an audit is identifying factors that may require extension or modification of the audit tests, such as potential related-party transactions or the possibility of material misstatements.

ANS: T PTS: 1
OBJ: Overview of the Audit Process: A Standards-Based Approach
NAT: AACSB-Analytical thinking | AICPA BB-Critical thinking

21. Evidence is required to be sufficient, reliable and relevant in order to provide a reasonable basis for audit conclusions.

ANS: T PTS: 1
OBJ: Generally Accepted Auditing Standards and IAASB Principles
NAT: AACSB-Analytical thinking | AICPA BB-Critical thinking

22. Fieldwork standards include planning and supervision, understanding the entity and its internal control structure, and obtaining sufficient audit evidence.

ANS: T PTS: 1
OBJ: Generally Accepted Auditing Standards and IAASB Principles
NAT: AACSB-Analytical thinking | AICPA BB-Critical thinking

23. Developing an understanding of the client's business and industry is essential to proficiency as discussed in the general standards of GAAS.

ANS: T PTS: 1
OBJ: Generally Accepted Auditing Standards and IAASB Principles
NAT: AACSB-Analytical thinking | AICPA BB-Critical thinking

24. The Sarbanes-Oxley Act completely prohibits auditors from performing consulting services for their audit clients.

ANS: F PTS: 1 OBJ: The Sarbanes-Oxley Act of 2002
NAT: AACSB-Analytical thinking | AICPA BB-Critical thinking

25. The Public Company Accounting Oversight Board (PCAOB) does not set standards for audits of public companies.
- ANS: F PTS: 1 OBJ: The Sarbanes-Oxley Act of 2002
NAT: AACSB-Analytical thinking | AICPA BB-Critical thinking
26. Independence is a facet of the General Standards of Fieldwork.
- ANS: F PTS: 1
OBJ: Generally Accepted Auditing Standards and IAASB Principles
NAT: AACSB-Analytical thinking | AICPA BB-Critical thinking
27. An auditor is required to communicate new accounting principles adopted by the organization to the audit committee.
- ANS: T PTS: 1
OBJ: Required Audit Firm Communication to the Audit Committee
NAT: AACSB-Analytical thinking | AICPA BB-Critical thinking
28. The Sarbanes-Oxley Act makes the audit committee the client of the audit firm.
- ANS: T PTS: 1 OBJ: The Sarbanes-Oxley Act of 2002
NAT: AACSB-Analytical thinking | AICPA BB-Critical thinking
29. The Public Company Accounting Oversight Board has five members, all of which must be CPAs.
- ANS: F PTS: 1 OBJ: The Sarbanes-Oxley Act of 2002
NAT: AACSB-Analytical thinking | AICPA BB-Critical thinking
30. The Public Company Accounting Oversight Board has the power of performing inspection of public accounting firms to determine their performance and check for improvements if any.
- ANS: T PTS: 1 OBJ: The Sarbanes-Oxley Act of 2002
NAT: AACSB-Analytical thinking | AICPA BB-Critical thinking
31. In order to safeguard independence of the firm, partners and managers of public accounting firms must go through a cooling off period prior to taking a high level position of employment with a public client company.
- ANS: T PTS: 1 OBJ: The Sarbanes-Oxley Act of 2002
NAT: AACSB-Analytical thinking | AICPA BB-Critical thinking
32. The Sarbanes-Oxley Act includes provisions requiring the auditor and the management to certify the financial statements and its disclosures and quality of internal controls.
- ANS: T PTS: 1 OBJ: The Sarbanes-Oxley Act of 2002
NAT: AACSB-Analytical thinking | AICPA BB-Critical thinking
33. The Sarbanes-Oxley Act requires that companies report on internal financial controls.
- ANS: T PTS: 1 OBJ: The Sarbanes-Oxley Act of 2002
NAT: AACSB-Analytical thinking | AICPA BB-Critical thinking

34. The Sarbanes-Oxley Act requires partners or managers significantly participating in audits to roll off the engagement every five years.

ANS: T PTS: 1 OBJ: The Sarbanes-Oxley Act of 2002
NAT: AACSB-Analytical thinking | AICPA BB-Critical thinking

35. The audit committee must be composed of outsiders such as the organization's attorney and audit partner.

ANS: F PTS: 1 OBJ: Enhanced Role of Audit Committees
NAT: AACSB-Analytical thinking | AICPA BB-Critical thinking

36. Management of companies should have the ability to hire and fire the external auditor.

ANS: F PTS: 1 OBJ: Enhanced Role of Audit Committees
NAT: AACSB-Analytical thinking | AICPA BB-Critical thinking

37. The audit committee should have the authority to hire and fire the external auditors.

ANS: T PTS: 1 OBJ: Enhanced Role of Audit Committees
NAT: AACSB-Analytical thinking | AICPA BB-Critical thinking

38. According to SAS 61, auditors are required to inform the audit committee of any significant audit adjustments discovered during the engagement.

ANS: T PTS: 1
OBJ: Required Audit Firm Communication to the Audit Committee
NAT: AACSB-Analytical thinking | AICPA BB-Critical thinking

39. Audit adjustments reflect upon the stewardship of the auditor over the financial statements of the client and the auditor's responsibility over the related disclosures.

ANS: F PTS: 1
OBJ: Required Audit Firm Communication to the Audit Committee
NAT: AACSB-Analytical thinking | AICPA BB-Critical thinking

40. The standards of fieldwork include the responsibility of the auditor to exercise due professional care.

ANS: F PTS: 1
OBJ: Generally Accepted Auditing Standards and IAASB Principles
NAT: AACSB-Analytical thinking | AICPA BB-Critical thinking

41. The purpose of the audit program is to discover material misstatements in the client's financial statements.

ANS: T PTS: 1
OBJ: Overview of the Audit Process: A Standards-Based Approach
NAT: AACSB-Analytical thinking | AICPA BB-Critical thinking

42. Planning is not required in an audit as long as an audit program has been developed.

ANS: F PTS: 1
OBJ: Overview of the Audit Process: A Standards-Based Approach
NAT: AACSB-Analytical thinking | AICPA BB-Critical thinking

43. A component of the reporting standards is the requirement that an opinion always be rendered on the subject matter.
- ANS: F PTS: 1
OBJ: Generally Accepted Auditing Standards and IAASB Principles
NAT: AACSB-Analytical thinking | AICPA BB-Critical thinking
44. An auditor must obtain an adequate amount of evidence and the evidence must be of the appropriate quality.
- ANS: T PTS: 1
OBJ: Generally Accepted Auditing Standards and IAASB Principles
NAT: AACSB-Analytical thinking | AICPA BB-Critical thinking
45. An auditor conducts a planning meeting in order to develop an understanding of internal controls.
- ANS: F PTS: 1
OBJ: Overview of the Audit Process: A Standards-Based Approach
NAT: AACSB-Analytical thinking | AICPA BB-Critical thinking
46. Materiality involves the degree of misstatement or omission that would affect the decision making process of the users of financial information.
- ANS: T PTS: 1
OBJ: Overview of the Audit Process: A Standards-Based Approach
NAT: AACSB-Analytical thinking | AICPA BB-Critical thinking
47. Materiality usually involve applying percentage to some base such as total assets, total revenue or pretax income.
- ANS: T PTS: 1
OBJ: Overview of the Audit Process: A Standards-Based Approach
NAT: AACSB-Analytical thinking | AICPA BB-Critical thinking
48. An auditor of financial statements gathers evidence for review purposes and does not test it.
- ANS: F PTS: 1
OBJ: Overview of the Audit Process: A Standards-Based Approach
NAT: AACSB-Analytical thinking | AICPA BB-Critical thinking
49. The Public Company Accounting Oversight Board obtains its authority to set audit standards for public companies from the U.S. Congress.
- ANS: T PTS: 1 OBJ: The Sarbanes-Oxley Act of 2002
NAT: AACSB-Analytical thinking | AICPA BB-Critical thinking
50. The American Institute of Certified Public Accountants no longer retains the right to set audit standards for any engagements as the Securities Exchange Commission has relinquished such power.
- ANS: F PTS: 1
OBJ: Overview of the Audit Process: A Standards-Based Approach
NAT: AACSB-Analytical thinking | AICPA BB-Critical thinking

MULTIPLE CHOICE

1. Corporate governance is a process by which the owners and creditors of an organization
 - a. exert control.
 - b. require accountability.
 - c. exert control and require accountability.
 - d. neither exert control nor require accountability.

ANS: C PTS: 1 OBJ: Corporate Governance and Auditing
NAT: AACSB-Analytical skills | AICPA BB-Critical thinking

2. The responsibility for operating an enterprise is delegated to the
 - a. auditor.
 - b. audit committee.
 - c. management.
 - d. board of directors.

ANS: C PTS: 1 OBJ: Corporate Governance and Auditing
NAT: AACSB-Analytical skills | AICPA BB-Critical thinking

3. The audit client of the CPA firm is
 - a. management.
 - b. the SEC.
 - c. the audit committee.
 - d. the stockholders.

ANS: C PTS: 1
OBJ: Corporate Governance Responsibilities and Failures
NAT: AACSB-Analytical skills | AICPA BB-Critical thinking

4. The audit committee has oversight responsibilities for
 - a. outside reporting.
 - b. internal auditing.
 - c. external auditing.
 - d.** all of the above.

ANS: D PTS: 1 OBJ: Enhanced Role of Audit Committees
NAT: AACSB-Analytical skills | AICPA BB-Critical thinking

5. Which of the following should be communicated by the auditor to the audit committee?
 - a. Auditor's responsibilities under GAAP.
 - b. All significant audit adjustments.
 - c. Significant accounting policies.
 - d.** all are required communications.

ANS: D PTS: 1 OBJ: Enhanced Role of Audit Committees
NAT: AACSB-Analytical skills | AICPA BB-Critical thinking

6. Which one of the following will provide auditing standards of public companies?
 - a. GAO
 - b. AICPA
 - c. GAAP
 - d. PCAOB

ANS: D PTS: 1 OBJ: The Sarbanes-Oxley Act of 2002
NAT: AACSB-Analytical skills | AICPA BB-Critical thinking

7. Which one of the following attributes is not required of an auditor in relation to audit clients?
- Independence
 - Bias
 - Integrity
 - Technical competence

ANS: B PTS: 1
OBJ: Generally Accepted Auditing Standards and IAASB Principles
NAT: AACSB-Analytical skills | AICPA BB-Critical thinking

8. The standards of competence, independence, and due professional care are covered by the
- general standards.
 - standards of field work.
 - reporting standards.
 - d.** none of the above.

ANS: A PTS: 1
OBJ: Generally Accepted Auditing Standards and IAASB Principles
NAT: AACSB-Analytical skills | AICPA BB-Critical thinking

9. The standards which present guidance in testing assertions and planning for the audit are known as
- general standards.
 - field work standards.
 - reporting standards.
 - d.** none of the above.

ANS: B PTS: 1
OBJ: Generally Accepted Auditing Standards and IAASB Principles
NAT: AACSB-Analytical skills | AICPA BB-Critical thinking

10. The standards which cover the essential elements of communication, the criteria against which the assertions were tested, and an explanation of the basis for the auditor's opinion are known as
- general standards.
 - standards of field work.
 - standards of reporting.
 - d.** none of the above.

ANS: C PTS: 1
OBJ: Generally Accepted Auditing Standards and IAASB Principles
NAT: AACSB-Analytical skills | AICPA BB-Critical thinking

11. Which generally accepted auditing standard is referred to as the cornerstone of auditing?
- Due professional care
 - Independence
 - Technical training
 - d.** None of the above

ANS: B PTS: 1
OBJ: Generally Accepted Auditing Standards and IAASB Principles
NAT: AACSB-Analytical skills | AICPA BB-Critical thinking

12. The PCAOB has the authority to do all of the following except:

- a. perform peer reviews on public accounting firms
- b. establish quality control standards for auditors of public companies
- c. take responsibility for an organization's financial statements
- d. set audit standards

ANS: C PTS: 1 OBJ: The Sarbanes-Oxley Act of 2002
NAT: AACSB-Analytical skills | AICPA BB-Critical thinking

13. Management of an organization has the responsibility for all of the following except:
- a. accounting principles used in financial reporting
 - b. engagement of a qualified auditor
 - c. internal control over financial reporting
 - d. financial statements and disclosures

ANS: B PTS: 1 OBJ: Corporate Responsibility for Financial Reporting
NAT: AACSB-Analytical skills | AICPA BB-Critical thinking

14. The Sarbanes-Oxley Act of 2002 requires management of public companies to
- a. certify the accuracy of financial statements.
 - b. establish a corporate code of conduct.
 - c. take accountability for restated earnings.
 - d.** all of the above

ANS: D PTS: 1 OBJ: The Sarbanes-Oxley Act of 2002
NAT: AACSB-Analytical skills | AICPA BB-Critical thinking

15. An audit committee must be comprised of outside directors and at least one outside financial expert. Which of the following is considered an outside director?
- a. A director who is not a member of management and has no other relationship to the organization.
 - b. A consultant to the organization who works as an honorary member of the board.
 - c. A director who is also a member of management and has no other relationship to the company.
 - d. A director who is a CPA and CIO of an affiliated organization.

ANS: A PTS: 1 OBJ: Enhanced Role of Audit Committees
NAT: AACSB-Analytical skills | AICPA BB-Critical thinking

16. Understanding the client does not involve which of the following?
- a. Development of an Preliminary audit program
 - b. A planning meeting
 - c. Preparation of management representations
 - d. Consideration of materiality

ANS: C PTS: 1
OBJ: Overview of the Audit Process: A Standards-Based Approach
NAT: AACSB-Analytical skills | AICPA BB-Critical thinking

17. Planning the audit requires which one of the following?
- a. Developing an understanding of the client's business and the industry in which it operates
 - b. Understanding the client's internal control structure
 - c. Developing an understanding of the client's accounting policies and procedures
 - d. A and C only
 - e.** All of the above

ANS: D PTS: 1

OBJ: Overview of the Audit Process: A Standards-Based Approach

NAT: AACSB-Analytical skills | AICPA BB-Critical thinking

18. The general standards of GAAS require all of the following of an auditor except:
- Technical training of the professionals involved in the audit
 - Independence of the auditor in fact and appearance
 - Conduct of an audit with the skill and care of a professional
 - Review of the work and audit documentation of the audit staff
 - All of the above

ANS: D PTS: 1

OBJ: Generally Accepted Auditing Standards and IAASB Principles

NAT: AACSB-Analytical skills | AICPA BB-Critical thinking

19. The proper supervision of audit assistants is a requirement of which of the Generally Accepted Auditing Standards?
- General Standards
 - Standards of Fieldwork
 - Standards of Reporting
 - Standards of Quality Control
 - None of the above

ANS: B PTS: 1

OBJ: Generally Accepted Auditing Standards and IAASB Principles

NAT: AACSB-Analytical skills | AICPA BB-Critical thinking

20. Which one of the following is not a reporting standard requirement?
- To standardize the nature of reporting
 - To facilitate communication with users of the financial statement
 - To identify and communicate some of the situations in which GAAP has not been consistently applied
 - To require the auditor to express an opinion

ANS: C PTS: 1

OBJ: Generally Accepted Auditing Standards and IAASB Principles

NAT: AACSB-Analytical skills | AICPA BB-Critical thinking

21. Auditing standards issued by the AICPA
- are no longer recognized by the PCAOB.
 - are no longer recognized by the profession because the AICPA voted itself out of existence.
 - continue to be issued by that organization for audits of public companies.
 - are recognized by the PCAOB as a starting point.

ANS: D PTS: 1

OBJ: Generally Accepted Auditing Standards and IAASB Principles

NAT: AACSB-Analytical skills | AICPA BB-Critical thinking

22. The auditor must understand the client's internal control as a component of the fieldwork standards. The one of the reason for this understanding is so that the auditor may
- provide individual comments on internal control non-compliance.
 - become comfortable that the client will pay its audit bills.
 - assess materiality.
 - assess the risk of possible misstatements in the financial statements.

ANS: D PTS: 1
OBJ: Generally Accepted Auditing Standards and IAASB Principles
NAT: AACSB-Analytical skills | AICPA BB-Critical thinking

23. An auditor engaged to audit the financial statements of a client obtains a sufficient understanding of the client's internal control for all of the following reasons except:
- Understanding the entity's internal control is a requirement of GAAS.
 - The auditor must use the information to assess the risk of material misstatements arising from the lack of internal control.
 - It is the primary basis for the audit report.
 - It assists the auditor in designing the nature, timing and extent of further audit procedures.

ANS: C PTS: 1
OBJ: Generally Accepted Auditing Standards and IAASB Principles
NAT: AACSB-Analytical skills | AICPA BB-Critical thinking

24. Which of the following members of the board of directors of McKeever Corporation is most qualified serve on McKeever's audit committee?
- Jon Adams, internal auditor of McKeever Corporation
 - Megan Wiley, attorney to McKeever Corporation
 - Karen Jones, consultant to McKeever Corporation
 - None of the above should serve on the audit committee of McKeever Corporation

ANS: D PTS: 1 OBJ: Enhanced Role of Audit Committees
NAT: AACSB-Analytical skills | AICPA BB-Critical thinking

25. Which of the following board of directors of Robbins Corporation should not serve on the audit committee?
- John Williams, professor at the University of Kalamazoo
 - Tyrone Marks, treasurer of Robbins Corporation
 - Stacy Bobbitt, member of the board of directors of the First National Bank and Trust
 - Jill Cemoss, chairman of the board of Big Brothers and Sisters, a non-profit organization

ANS: B PTS: 1 OBJ: Enhanced Role of Audit Committees
NAT: AACSB-Analytical skills | AICPA BB-Critical thinking

26. For an auditor to be independent, he or she must be independent in
- fact.
 - appearance.
 - fact and appearance.
 - either fact or appearance.

ANS: C PTS: 1
OBJ: Generally Accepted Auditing Standards and IAASB Principles
NAT: AACSB-Analytical skills | AICPA BB-Critical thinking

27. The Sarbanes-Oxley Act of 2002 requires which of the following?
- Only the largest four accounting firms may audit public companies.
 - Smaller public companies that cannot afford to become compliant with the act must delist and become pink sheet companies.
 - All publicly held companies will provide a report on internal control over financial reporting.
 - Chief financial officers of public companies must be CPAs.

ANS: C PTS: 1 OBJ: The Sarbanes-Oxley Act of 2002

NAT: AACSB-Analytical skills | AICPA BB-Critical thinking

28. The Public Company Accounting Oversight Board was established by:
- an act of Congress.
 - the Securities and Exchange Commission.
 - the Public Oversight Board.
 - the self-governing association of certified public accountants.

ANS: A PTS: 1 OBJ: The Sarbanes-Oxley Act of 2002

NAT: AACSB-Analytical skills | AICPA BB-Critical thinking

29. Brooklyn Mercantile, Inc., a public company, receives audit services from Gregory and Elder, LLC. Brooklyn may engage Gregory and Elder to perform corporate tax returns only if:
- Gregory and Elder is registered with the PCAOB.
 - Gregory and Elder is independent of Brooklyn for tax purposes.
 - tax services by Gregory and Elder are approved by Brooklyn's audit committee.
 - the PCAOB approves such "non-audit" services in writing.

ANS: C PTS: 1 OBJ: The Sarbanes-Oxley Act of 2002

NAT: AACSB-Analytical skills | AICPA BB-Critical thinking

30. Audit committees are required to have what person in its composition?
- A CPA
 - A public regulator
 - A financial expert
 - An attorney-at-law

ANS: C PTS: 1 OBJ: The Sarbanes-Oxley Act of 2002

NAT: AACSB-Analytical skills | AICPA BB-Critical thinking

31. According to the Sarbanes-Oxley Act of 2002, how often must audit managers and partners rotate off an engagement of a public company?
- Each busy season
 - When independence is in question
 - Every five years
 - Managers and partners are not required to rotate off of public client engagements

ANS: C PTS: 1 OBJ: The Sarbanes-Oxley Act of 2002

NAT: AACSB-Analytical skills | AICPA BB-Critical thinking

32. Which of the following are the CEO and CFO of a public company prohibited from performing under the Sarbanes-Oxley Act of 2002?
- Certification of financial statements
 - Disclosure of off-balance sheet transactions
 - Reporting on internal control over financial reporting
 - Taking personal loans from the company

ANS: D PTS: 1 OBJ: The Sarbanes-Oxley Act of 2002

NAT: AACSB-Analytical skills | AICPA BB-Critical thinking

33. The organization that will continue to set auditing standards for firms auditing private companies is the
- FASB
 - GAO
 - SEC
 - AICPA

ANS: D PTS: 1 OBJ: The Sarbanes-Oxley Act of 2002
NAT: AACSB-Analytical skills | AICPA BB-Critical thinking

34. The AICPA is an organization that is
- historically self-regulated.
 - regulated by the federal government.
 - regulated the state governments.
 - a new organization established by an act of congress in 2002.

ANS: A PTS: 1 OBJ: Corporate Governance and Auditing
NAT: AACSB-Analytical skills | AICPA BB-Critical thinking

35. Audit planning begins with which of the following events?
- Issuance of a management representation letter
 - Accumulation of audit evidence
 - A discussion with the audit team, the client management and its audit committee
 - A determination of the audit report to be rendered

ANS: C PTS: 1
OBJ: Overview of the Audit Process: A Standards-Based Approach
NAT: AACSB-Analytical skills | AICPA BB-Critical thinking

36. An auditor is concerned with materiality for which of the following reasons?
- To assess internal control
 - To comply with the quality assurance standards of GAAS
 - To determine the effects of misstatements on the users of financial information
 - To cut down on audit procedures and testing

ANS: C PTS: 1
OBJ: Overview of the Audit Process: A Standards-Based Approach
NAT: AACSB-Analytical skills | AICPA BB-Critical thinking

37. An auditor meets with the audit client in the planning stage in order to discuss all of the following except:
- specific audit procedures and tests to be performed by the auditor
 - the scope of audit services to be performed
 - the use of the internal auditors by the external audit firm
 - responsibilities and expectations of each party

ANS: A PTS: 1
OBJ: Overview of the Audit Process: A Standards-Based Approach
NAT: AACSB-Analytical skills | AICPA BB-Critical thinking

38. In the audit team's determination of materiality, it is important that:
- large percentages of sales are used to "lower the blade" of audit testing
 - materiality is assessed sufficient to provide a low level of assurance that misstatements will be discovered
 - only the most senior of auditors is involved in the calculation of materiality
 - changes to financial trends or ratios are considered in addition to overall materiality levels

ANS: D PTS: 1
OBJ: Overview of the Audit Process: A Standards-Based Approach
NAT: AACSB-Analytical skills | AICPA BB-Critical thinking

39. Which of the following would not affect an auditor's judgment concerning materiality?

- a. Adjustments at individual transaction levels without consideration of offsets
- b. The possibility of swings in accounting estimates from period-to-period
- c. Recurring misstatements that are passed over each year under audit
- d. All of the above must be considered in materiality decisions by auditors**

ANS: D PTS: 1

OBJ: Overview of the Audit Process: A Standards-Based Approach

NAT: AACSB-Analytical skills | AICPA BB-Critical thinking

40. Which of the following would an auditor perform in order to develop an effective audit program?
- a. Develop an understanding of the client's business and industry
 - b. Test specific financial statement accounts and balances
 - c. Obtain a management representation letter from the client management
 - d. Disregard related party transactions

ANS: A PTS: 1

OBJ: Overview of the Audit Process: A Standards-Based Approach

NAT: AACSB-Analytical skills | AICPA BB-Critical thinking

41. Planning procedures performed to develop an audit program consist of all of the following except:
- a. determination of client company risks
 - b. determination of the audit opinion that will be rendered
 - c. development of a preliminary understanding of the quality of the client's internal control
 - d. anticipation of audit adjustments that will be required

ANS: B PTS: 1

OBJ: Overview of the Audit Process: A Standards-Based Approach

NAT: AACSB-Analytical skills | AICPA BB-Critical thinking

42. A proper system of corporate governance is one that demands
- a. decision making by auditors in place of management.
 - b. accountability back through the system to the shareholders.
 - c. internal audit representation on the board of directors.
 - d. audit planning to obtain competent and sufficient audit evidence.

ANS: B PTS: 1 OBJ: Corporate Governance and Auditing

NAT: AACSB-Analytical skills | AICPA BB-Critical thinking

43. Which of the following requirements are not included in the attestation fieldwork standards?
- a. Adequate planning and supervision.
 - b. Evaluation of internal control.
 - c. Sufficient, competent evidential matter.
 - d. All are required fieldwork standards.

ANS: B PTS: 1 OBJ: Attestation Standards

NAT: AACSB-Analytical skills | AICPA BB-Critical thinking

44. There are ten generally accepted auditing standards broken up in to three categories, i.e., general, fieldwork, and reporting. Which of the following standards is one of the general standards?
- a. Training and proficiency.
 - b. Internal control.
 - c. Sufficient, competent evidence.
 - d. Consistency.

ANS: A PTS: 1

OBJ: Generally Accepted Auditing Standards and IAASB Principles

NAT: AACSB-Analytical skills | AICPA BB-Critical thinking

45. There are ten generally accepted auditing standards broken up into three categories, i.e., general, fieldwork, and reporting. Which of the following standards is one of the reporting standards?
- Consistency.
 - Sufficient, competent evidence.
 - Internal control.
 - Planning and supervision.

ANS: A PTS: 1

OBJ: Generally Accepted Auditing Standards and IAASB Principles

NAT: AACSB-Analytical skills | AICPA BB-Critical thinking

46. There are ten generally accepted auditing standards broken up into three categories, i.e., general, fieldwork, and reporting. Which of the following standards is one of the fieldwork standards?
- Independence.
 - GAAP.
 - Internal control.
 - Disclosure.

ANS: C PTS: 1

OBJ: Generally Accepted Auditing Standards and IAASB Principles

NAT: AACSB-Analytical skills | AICPA BB-Critical thinking

ESSAY

1. The role of the auditor and the audit committee

Describe the relationship between the external auditor and the audit committee of the company receiving audit services.

ANS:

The audit committee hires the auditor to perform audits of financial statements that are the representations and responsibilities of management. The audit committee is the literal client of the auditor. The audit committee has the responsibility to assess the quality of audit services received, including the independence of the external audit firm. The audit committee has the ultimate ability to fire the audit firm.

According to SAS 61 of the auditing standards, the auditors must communicate specific issues to the audit committee. These items of communication include:

- The firm's responsibility to audit in accordance with Generally Accepted Auditing Standards and its responsibility to review other information contained in annual reports and public documents.
 - The client company's adoption of significant accounting policies and principles.
 - The client company management's judgments and estimates of certain accounting balances.
 - Significant audit adjustments proposed by the auditors.
- All major accounting disagreements with management whether or not resolved.

PTS: 1 OBJ: Required Audit Firm Communication to the Audit Committee

NAT: AACSB-Communications ability, Analytical skills | AICPA BB-Critical thinking

2. Characteristics of an effective audit committee

List and discuss at least four attributes of an effective audit committee that provides important oversight functions.

ANS:

Attributes of an effective audit committee includes:

1. The audit committee members should be comprised of outside directors. Outside directors are not members of management and they do not have other relationships with the company.
2. The audit committee members should be financially literate and at least one member should have financial expertise.
3. The committee should be responsible for assessing the independence of the auditor.
4. The committee should have a discussion with the auditor about the auditor's judgments about the company's accounting principles.
5. The committee should be apprised of significant changes in accounting information systems and the related controls.
6. The committee should receive all regulatory reports and meet periodically with regulatory auditors to discuss findings and concerns.
7. The committee should have direct oversight over the internal audit function. It should review the budget, should review the audit plan and discuss internal audit findings.
8. The committee should meet regularly to discuss all matters of corporate governance.
9. The committee may consider separation of the Chairman of the Board and CEO positions.

PTS: 1 OBJ: Enhanced Role of Audit Committees

NAT: AACSB-Communications ability, Analytical skills | AICPA BB-Critical thinking

3. Audit planning

Identify at least four steps involved in the planning of an audit.

ANS:

Steps involved in planning an audit include:

1. Meet with the client audit committee and the key management of the company to develop an understanding of important audit issues.
2. Develop an understanding of the client's business and the industry within which it operates.
3. Develop an understanding of audit risk and materiality.
4. Develop an understanding of the client's accounting policies and procedures.
5. Anticipate financial statement items likely to require adjustments.
6. Develop an understanding management's readiness for the audit.
7. Determine the scope of services to be performed.

PTS: 1 OBJ: Overview of the Audit Process: A Standards-Based Approach

NAT: AACSB-Communications ability, Analytical skills | AICPA BB-Critical thinking

4. Auditor independence

Discuss the requirement of auditors to be independent in fact and appearance. Why is "independence" referred to as the cornerstone of auditing?

ANS:

The auditor must be independent in their mental attitude in conducting the audit as well as in the perception of users. The auditor must favor neither the client nor third parties in gathering evidence and evaluating the fairness of financial statements.

Independence is referred to as the cornerstone of auditing because without independence, the value of the auditor's attestation function would be decreased in the eyes of a third party who relies on the auditor's communication. Because the auditor's report is used by many different users with different purposes, the reports must be judged by all to be unbiased and free from favoritism for any party.

PTS: 1 OBJ: Generally Accepted Auditing Standards and IAASB Principles
NAT: AACSB-Communications ability, Analytical skills | AICPA BB-Critical thinking

5. Write the three general auditing standards.

ANS:

The general audit standards are:

1. **Technical Training and proficiency:** The examination is to be performed by a person or persons having adequate technical training and proficiency as an auditor.
2. **Independence:** An independence is mental attitude is to be maintained by the auditor or auditors.
3. **Due Professional Care:** Due professional care is to be exercised in the performance of the examination and the preparation of the report.

PTS: 1 OBJ: Generally Accepted Auditing Standards and IAASB Principles
NAT: AACSB-Communications ability, Analytical skills | AICPA BB-Critical thinking

6. Explain the meaning of due professional care.

ANS:

Due professional care refers to the **skill** and **care** of a professional expected in an audit. Following Generally Accepted Auditing Standards (GAAS) is one benchmark for due professional care. However, following GAAS is not always sufficient. If a reasonably prudent person would have done more, the professional should do at least as much. Due professional care is also determined by evaluating whether someone with similar skills in a similar situation would have performed the same way as the auditor.

PTS: 1 OBJ: Generally Accepted Auditing Standards and IAASB Principles
NAT: AACSB-Communications ability, Analytical skills | AICPA BB-Critical thinking

7. Contrast differences in the eleven attestation standards to the ten generally accepted auditing standards.

ANS:

The attestation standards are broader in scope and include the 10 GAAS. The attestation standards were developed to address the need to provide attest services using criteria other than generally accepted accounting principles or other comprehensive basis of accounting (cash, tax, regulatory, other). Thus when financial statements are attested to by auditors then the 10 GAAS standards apply in expressing an opinion on them. When performing attestations where the criteria is other than GAAP, then the attestation standards apply.

As a result, two new general standards apply. Practitioners now have to evaluate their knowledge in the subject matter and also evaluate the reasonableness of the criteria and whether it is capable of reasonable consistent estimation.

Also the internal control standard was dropped out of fieldwork. Because of the broadness of potential criteria that may be used, internal control may not be relevant.

The reporting standards were completely changed. Now the assertion being reported on has to be stated and the character of the examination, the conclusion stated and any significant reservations, and in some circumstances the report should be restricted to the parties involved and knowledgeable about the matter.

PTS: 1 OBJ: Attestation Standards

NAT: AACSB-Communications ability, Analytical skills | AICPA BB-Critical thinking

8. Discuss what corporate governance is and briefly describe an overview of the corporate governance process.

ANS:

Corporate governance is defined as “a process by which the owners and creditors of an organization exert control and require accountability for the resources entrusted to the organization. The owners (stockholders) elect a board of directors to provide oversight of the organization’s activities.”

Responsibility runs down the organization. Governance starts with the stockholders/owners delegating responsibilities through an elected board of directors to management and, in turn, to operating units with oversight and assistance from internal auditors. Accountability runs upward in the organization. Operations personnel are held responsible for their actions and decisions by management, Management has to account for their decisions and actions to the board of directors, and both the board and management are held accountable by the stockholders.

PTS: 1 OBJ: Corporate Governance and Auditing

NAT: AACSB-Communications ability, Analytical skills | AICPA BB-Critical thinking