***Principles of Auditing & Other Assurance Services, 21e* (Whittington)**

**Chapter 1 The Role of the Public Accountant in the American Economy**

1) Independent audits of today place more emphasis on sampling than did the audits of the 19th century.

Answer: TRUE

Difficulty: 2 Medium

Topic: Financial Statement Audits

Learning Objective: 01-04 Explain why audits are demanded by society.

Bloom's: Remember

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

2) The American Institute of Certified Public Accountants creates the CPA Exam, while individual states issue CPA certificates and permits CPAs to practice.

Answer: TRUE

Difficulty: 2 Medium

Topic: The Public Accounting Profession

Learning Objective: 01-07 Explain the regulatory process for auditors of public companies and auditors of nonpublic companies.

Bloom's: Remember

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

3) The GAO is limited by statute to performing only compliance audits.

Answer: FALSE

Difficulty: 1 Easy

Topic: Financial Statement Audits

Learning Objective: 01-06 Contrast the various types of audits and types of auditors.

Bloom's: Remember

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

4) The SEC does not pass on the merits of the securities that are registered with the agency.

Answer: TRUE

Difficulty: 2 Medium

Topic: The Public Accounting Profession

Learning Objective: 01-07 Explain the regulatory process for auditors of public companies and auditors of nonpublic companies.

Bloom's: Remember

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

5) The American Institute of Certified Public Accountants has the primary authority to establish accounting standards.

Answer: FALSE

Difficulty: 1 Easy

Topic: The Public Accounting Profession

Learning Objective: 01-07 Explain the regulatory process for auditors of public companies and auditors of nonpublic companies.

Bloom's: Remember

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

6) When a CPA firm enrolls in the AICPA Peer Review Program, it agrees to comply with the AICPA's Quality Control Standards and to have a peer review of its accounting and auditing practice every seven years.

Answer: FALSE

Difficulty: 2 Medium

Topic: The Public Accounting Profession

Learning Objective: 01-07 Explain the regulatory process for auditors of public companies and auditors of nonpublic companies.

Bloom's: Remember

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

7) Despite the high cost, most small companies have their financial statements audited by a CPA firm, so they can obtain a loan.

Answer: FALSE

Difficulty: 1 Easy

Topic: The Public Accounting Profession

Learning Objective: 01-07 Explain the regulatory process for auditors of public companies and auditors of nonpublic companies.

Bloom's: Remember

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

8) Senior auditors in CPA firms may be responsible for planning and coordinating audits on smaller engagements.

Answer: TRUE

Difficulty: 1 Easy

Topic: The Public Accounting Profession

Learning Objective: 01-08 Describe how public accounting firms are typically organized and the responsibilities of auditors at the various levels in the organization.

Bloom's: Remember

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

9) The Sarbanes-Oxley Act requires that auditors of certain publicly traded companies in the United States perform an integrated audit that includes providing assurance on both the financial statements and on compliance with laws and regulations.

Answer: FALSE

Difficulty: 2 Medium

Topic: Financial Statement Audits

Learning Objective: 01-06 Contrast the various types of audits and types of auditors.

Bloom's: Remember

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

10) Auditing is frequently only a small part of the practice of local CPA firms.

Answer: TRUE

Difficulty: 2 Medium

Topic: The Public Accounting Profession

Learning Objective: 01-08 Describe how public accounting firms are typically organized and the responsibilities of auditors at the various levels in the organization.

Bloom's: Remember

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

11) A summary of findings rather than assurance is most likely to be included in a(n):

A) Agreed-upon procedures report.

B) Compilation report.

C) Examination report.

D) Review report.

Answer: A

Difficulty: 2 Medium

Topic: The Attest Function

Learning Objective: 01-02 Identify assurance services that involve attestation.

Bloom's: Remember

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

12) The Statements on Auditing Standards have been issued by the:

A) Auditing Standards Board.

B) Financial Accounting Standards Board.

C) Securities and Exchange Commission.

D) Federal Bureau of Investigation.

Answer: A

Difficulty: 1 Easy

Topic: The Public Accounting Profession

Learning Objective: 01-07 Explain the regulatory process for auditors of public companies and auditors of nonpublic companies.

Bloom's: Remember

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

13) The risk that a company's financial statements will materially depart from generally accepted accounting principles is referred to as:

A) Business Risk.

B) Information Risk.

C) Detection Risk.

D) Control Risk.

Answer: B

Difficulty: 1 Easy

Topic: Financial Statement Audits

Learning Objective: 01-04 Explain why audits are demanded by society.

Bloom's: Remember

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

14) Historically, which of the following has the AICPA been **most** concerned with providing?

A) Professional standards for CPAs.

B) Professional guidance for regulating financial markets.

C) Standards guiding the conduct of internal auditors.

D) Staff support to Congress.

Answer: A

Difficulty: 2 Medium

Topic: The Public Accounting Profession

Learning Objective: 01-07 Explain the regulatory process for auditors of public companies and auditors of nonpublic companies.

Bloom's: Remember

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

15) The organization charged with protecting investors and the public by requiring full disclosure of financial information by companies offering securities to the public is the:

A) Auditing Standards Board.

B) Financial Accounting Standards Board.

C) Government Accounting Standards Boards.

D) Securities and Exchange Commission.

Answer: D

Difficulty: 2 Medium

Topic: The Public Accounting Profession

Learning Objective: 01-07 Explain the regulatory process for auditors of public companies and auditors of nonpublic companies.

Bloom's: Remember

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

16) An engagement in which a CPA firm arranges for a critical review of its practices by another CPA firm is referred to as a(n):

A) Peer Review Engagement.

B) Quality Control Engagement.

C) Quality Assurance Engagement.

D) Attestation Engagement.

Answer: A

Difficulty: 1 Easy

Topic: The Public Accounting Profession

Learning Objective: 01-07 Explain the regulatory process for auditors of public companies and auditors of nonpublic companies.

Bloom's: Remember

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

17) The sequentially-numbered pronouncements issued by the Auditing Standards Board over a period of years are known as:

A) Auditing Statements of Position (ASPs).

B) Accounting Series Releases (ASRs).

C) Statements on Auditing Standards (SASs).

D) Statements on Auditing Principles (SAPs).

Answer: C

Difficulty: 1 Easy

Topic: The Public Accounting Profession

Learning Objective: 01-07 Explain the regulatory process for auditors of public companies and auditors of nonpublic companies.

Bloom's: Remember

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

18) The Government Accountability Office (GAO):

A) is primarily concerned with rapid processing of all accounts payable incurred by the federal government.

B) Responsibilities include conducting operational audits to ensure spending meets Congress's requirements.

C) is a multinational organization of professional accountants.

D) is primarily concerned with budgets and forecasts approved by the SEC.

Answer: B

Difficulty: 1 Easy

Topic: Financial Statement Audits

Learning Objective: 01-06 Contrast the various types of audits and types of auditors.

Bloom's: Remember

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

19) The risk associated with survivability and profitability is referred to as

A) Information risk.

B) Inherent risk.

C) Relative risk.

D) Business risk.

Answer: D

Difficulty: 1 Easy

Topic: Financial Statement Audits

Learning Objective: 01-04 Explain why audits are demanded by society.

Bloom's: Remember

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

20) The risk that a company will ***not*** be able to meet its obligations when they become due is an aspect of:

A) Information risk.

B) Inherent risk.

C) Relative risk.

D) Business risk.

Answer: D

Difficulty: 1 Easy

Topic: Financial Statement Audits

Learning Objective: 01-04 Explain why audits are demanded by society.

Bloom's: Remember

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

21) Which of the following attributes is more essential for an auditor than of management?

A) Integrity.

B) Competence.

C) Independence.

D) Keeping informed on current professional developments.

Answer: C

Difficulty: 1 Easy

Topic: What Are Assurance Services?

Learning Objective: 01-01 Describe the nature of assurance services.

Bloom's: Remember

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

22) The attest function:

A) Is an essential part of every engagement by the CPA, whether performing auditing, tax work, or other services.

B) Includes the preparation of a report of the CPA's findings.

C) Requires a consideration of internal control.

D) Requires a complete review of all transactions during the period under examination.

Answer: B

Difficulty: 2 Medium

Topic: The Attest Function

Learning Objective: 01-02 Identify assurance services that involve attestation.

Bloom's: Remember

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

23) Attestation risk is limited to a low level in which of the following engagement(s)?

A) Both examinations and reviews.

B) Examinations, but not reviews.

C) Reviews, but not examinations.

D) Neither examinations nor reviews.

Answer: B

Difficulty: 1 Easy

Topic: The Attest Function

Learning Objective: 01-02 Identify assurance services that involve attestation.

Bloom's: Remember

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

24) When compared to an audit performed prior to 1900, an audit today:

A) Is more likely to use sampling.

B) Is less likely to include consideration of the effectiveness of internal control.

C) Has bank loan officers as the primary financial statement user group.

D) Includes a more detailed examination of all individual transactions.

Answer: A

Difficulty: 2 Medium

Topic: Financial Statement Audits

Learning Objective: 01-04 Explain why audits are demanded by society.

Bloom's: Remember

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

25) Which of the following are issued by the Securities and Exchange Commission?

A) Accounting and Auditing Enforcement Releases.

B) Accounting Trends and Techniques.

C) Industry Audit Guides.

D) Statements of Position.

Answer: A

Difficulty: 2 Medium

Topic: The Public Accounting Profession

Learning Objective: 01-07 Explain the regulatory process for auditors of public companies and auditors of nonpublic companies.

Bloom's: Remember

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

26) Which of the following is not correct relating to the Sarbanes-Oxley Act?

A) It toughens penalties for corporate fraud.

B) It restricts the types of consulting CPAs may perform for audit clients.

C) It applies to both public and nonpublic audit clients.

D) It eliminates a significant portion of the accounting profession's system of self-regulation.

Answer: C

Difficulty: 2 Medium

Topic: Financial Statement Audits

Learning Objective: 01-05 Describe how the credibility of the accounting profession was affected by the large number of companies reporting accounting irregularities in the beginning of this century.

Bloom's: Remember

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

27) An operational audit differs in many ways from an audit of financial statements. Which of the following is the best example of one of these differences?

A) The usual audit of financial statements covers the four basic statements, whereas the operational audit is usually limited to either the balance sheet or the income statement.

B) Operational audits are more subjective and often involve evaluating efficiency and effectiveness of operations.

C) Operational audits do not ordinarily result in the preparation of a report.

D) The operational audit deals with pre-tax income.

Answer: B

Difficulty: 2 Medium

Topic: Financial Statement Audits

Learning Objective: 01-06 Contrast the various types of audits and types of auditors.

Bloom's: Remember

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

28) The review of a company's financial statements by a CPA firm:

A) Is substantially less in scope of procedures than an audit.

B) Requires detailed analysis of the major accounts.

C) Is of similar scope as an audit and adds similar credibility to the statements.

D) Culminates in issuance of a report expressing the CPA's opinion as to the fairness of the statements.

Answer: A

Difficulty: 1 Easy

Topic: The Attest Function

Learning Objective: 01-02 Identify assurance services that involve attestation.

Bloom's: Remember

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

29) Which statement is correct with respect to continuing professional education (CPE) requirements of members of the AICPA?

A) Only members employed by the AICPA are required to take such courses.

B) Only members in public practice are required to take such courses.

C) Members, regardless of whether they are in public practice, are required to meet such requirements.

D) There is no requirement for members to participate in CPE.

Answer: C

Difficulty: 2 Medium

Topic: The Public Accounting Profession

Learning Objective: 01-07 Explain the regulatory process for auditors of public companies and auditors of nonpublic companies.

Bloom's: Remember

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

30) The FDIC Improvement Act requires that management of large financial institutions engage auditors to attest to assertions by management about the effectiveness of the institution's internal controls over:

A) Broker and dealer relationships.

B) Financial reporting.

C) Effectiveness of operations.

D) Efficiency of operations.

Answer: B

Difficulty: 2 Medium

Topic: Financial Statement Audits

Learning Objective: 01-04 Explain why audits are demanded by society.

Bloom's: Remember

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

31) Passage of the Sarbanes-Oxley Act led to the establishment of the:

A) Auditing Standards Board.

B) Public Company Accounting Oversight Board.

C) Public Accountancy Review Board.

D) Securities and Exchange Commission.

Answer: B

Difficulty: 2 Medium

Topic: Financial Statement Audits

Learning Objective: 01-05 Describe how the credibility of the accounting profession was affected by the large number of companies reporting accounting irregularities in the beginning of this century.

Bloom's: Remember

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

32) Which of the following professionals has primary responsibility for the performance of an audit?

A) The managing partner of the firm.

B) The senior assigned to the engagement.

C) The manager assigned to the engagement.

D) The partner in charge of the engagement.

Answer: D

Difficulty: 2 Medium

Topic: The Public Accounting Profession

Learning Objective: 01-08 Describe how public accounting firms are typically organized and the responsibilities of auditors at the various levels in the organization.

Bloom's: Remember

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

33) Which of the following types of services is generally provided only by CPA firms?

A) Tax audits.

B) Financial statement audits.

C) Compliance audits.

D) Operational audits.

Answer: B

Difficulty: 2 Medium

Topic: The Attest Function

Learning Objective: 01-02 Identify assurance services that involve attestation.

Bloom's: Remember

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

34) The right to practice as a CPA is given by which of the following organizations?

A) State Boards of Accountancy.

B) The AICPA.

C) The SEC.

D) The General Accounting Office.

Answer: A

Difficulty: 2 Medium

Topic: The Public Accounting Profession

Learning Objective: 01-07 Explain the regulatory process for auditors of public companies and auditors of nonpublic companies.

Bloom's: Remember

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

35) Which of the following terms best describes the audit of a taxpayer's tax return by an IRS auditor?

A) Operational audit.

B) Internal audit.

C) Compliance audit.

D) Government audit.

Answer: C

Difficulty: 2 Medium

Topic: Financial Statement Audits

Learning Objective: 01-06 Contrast the various types of audits and types of auditors.

Bloom's: Remember

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

36) Inquiries and analytical procedures ordinarily form the basis for which type of engagement?

A) Agreed-upon procedures.

B) Audit.

C) Examination.

D) Review.

Answer: D

Difficulty: 1 Easy

Topic: The Attest Function

Learning Objective: 01-02 Identify assurance services that involve attestation.

Bloom's: Remember

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

37) Which of the following best describes the reason why independent auditors report on financial statements?

A) A management fraud may exist and it is more likely to be detected by independent auditors.

B) An audit provides credibility to the financial statements.

C) A misstatement of account balances may exist and is generally corrected as the result of the independent auditors' work.

D) Poorly designed internal control may be in existence.

Answer: B

Difficulty: 2 Medium

Topic: Financial Statement Audits

Learning Objective: 01-04 Explain why audits are demanded by society.

Bloom's: Remember

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

38) Financial accounting standards for cities are developed primarily by the

A) FASB.

B) IFAC.

C) GASB.

D) SEC.

Answer: C

Difficulty: 3 Hard

Topic: Financial Statement Audits

Learning Objective: 01-06 Contrast the various types of audits and types of auditors.

Bloom's: Understand

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

39) Operational auditing is primarily oriented toward:

A) Future improvements to accomplish the goals of management.

B) The accuracy of data reflected in management's financial records.

C) The verification that a company's financial statements are fairly presented.

D) Past protection provided by existing internal control.

Answer: A

Difficulty: 3 Hard

Topic: Financial Statement Audits

Learning Objective: 01-06 Contrast the various types of audits and types of auditors.

Bloom's: Understand

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

40) A typical objective of an operational audit is for the auditor to:

A) Determine whether the financial statements fairly present the entity's operations.

B) Evaluate the feasibility of attaining the entity's operational objectives.

C) Make recommendations for improving performance.

D) Report on the entity's relative success in attaining profit maximization.

Answer: C

Difficulty: 3 Hard

Topic: Financial Statement Audits

Learning Objective: 01-06 Contrast the various types of audits and types of auditors.

Bloom's: Understand

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

41) An integrated audit performed under the Sarbanes-Oxley Act requires that auditors report on:

|  |  |  |
| --- | --- | --- |
|  | Financial Statements | Internal Control |
| A. | Yes | Yes |
| B. | Yes | No |
| C. | No | Yes |
| D. | No | No |

A) Option A

B) Option B

C) Option C

D) Option D

Answer: A

Difficulty: 2 Medium

Topic: Financial Statement Audits

Learning Objective: 01-06 Contrast the various types of audits and types of auditors.

Bloom's: Remember

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

42) In United States v. Arthur Young, the Supreme Court of the United States described the auditor's role as requiring independence, complete fidelity to the public trust and to serve as a(n):

A) Objective observer.

B) Public watchdog.

C) Independent detective.

D) Inspector with high morals.

Answer: B

Difficulty: 2 Medium

Topic: Financial Statement Audits

Learning Objective: 01-04 Explain why audits are demanded by society.

Bloom's: Remember

AACSB: Ethics

Accessibility: Keyboard Navigation

43) International Standards on Auditing are issued by

A) International Standards Board.

B) International Auditing and Assurance Standards Board.

C) Public Company Accounting Oversight Board.

D) International Auditing Education Standards Board.

Answer: B

Difficulty: 2 Medium

Topic: Public Accounting Profession

Learning Objective: 01-07 Explain the regulatory process for auditors of public companies and auditors of nonpublic companies.

Bloom's: Remember

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

44) In cases of a publicly traded company audit in the United States, when International Standards on Auditing (ISAs) conflict with the PCAOB, standards, which of the following is correct?

A) The ISA is applicable.

B) The PCAOB standard is applicable.

C) The substance of the conflict should be analyzed, and the ISA or PCAOB treatment that seems more appropriate is applicable.

D) Both sets of standards have equal applicability.

Answer: B

Difficulty: 2 Medium

Topic: Public Accounting Profession

Learning Objective: 01-07 Explain the regulatory process for auditors of public companies and auditors of nonpublic companies.

Bloom's: Apply

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

45) An audit of the financial statements of a company is referred to as a(n)

A) Financial audit.

B) Compliance audit.

C) Operational audit.

D) Integrated financial audit.

Answer: A

Difficulty: 1 Easy

Topic: Types of Audits

Learning Objective: 01-06 Contrast the various types of audits and types of auditors.

Bloom's: Remember

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

46) An act passed by Congress aimed at promoting financial stability improving accountability and transparency in the financial system:

A) Better governance Act.

B) Dodd-Frank Act.

C) Public Company Accounting Oversight Board Act.

D) Sarbanes-Oxley Act.

Answer: B

Difficulty: 2 Medium

Topic: Financial Statement Audits

Learning Objective: 01-05 Describe how the credibility of the accounting profession was affected by the large number of companies reporting accounting irregularities in the beginning of this century.

Bloom's: Remember

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

47) The financial statements of a United States public company are most likely to follow:

A) Generally accepted accounting principles.

B) International Standards of Auditing.

C) Public Company Accounting Oversight Board Principles.

D) Quality control standards.

Answer: A

Difficulty: 2 Medium

Topic: The Attest Function

Learning Objective: 01-02 Identify assurance services that involve attestation.

Bloom's: Remember

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

Accountants are regulated by a variety of organizations. Match the following statements with the most directly related organizations. Organizations may be used once or not at all.

48) Develop accounting standards for public and nonpublic companies.

Answer: Financial Accounting Standards Board.

Difficulty: 2 Medium

Topic: Financial Statement Audits; Public Accounting Profession

Learning Objective: 01-07 Explain the regulatory process for auditors of public companies and auditors of nonpublic companies.; 01-06 Contrast the various types of audits and types of auditors.

Bloom's: Remember

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

49) Develop accounting standards for the U.S. Government.

Answer: Federal Accounting Standards Advisory Board.

Difficulty: 2 Medium

Topic: Financial Statement Audits; Public Accounting Profession

Learning Objective: 01-07 Explain the regulatory process for auditors of public companies and auditors of nonpublic companies.; 01-06 Contrast the various types of audits and types of auditors.

Bloom's: Remember

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

50) Formed to improve standards of financial accounting for state and local government entities.

Answer: Government Accounting Standards Board.

Difficulty: 2 Medium

Topic: Financial Statement Audits; Public Accounting Profession

Learning Objective: 01-07 Explain the regulatory process for auditors of public companies and auditors of nonpublic companies.; 01-06 Contrast the various types of audits and types of auditors.

Bloom's: Remember

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

51) Issue auditing standards for public companies.

Answer: Public Company Accounting Oversight Board.

Difficulty: 2 Medium

Topic: Financial Statement Audits; Public Accounting Profession

Learning Objective: 01-07 Explain the regulatory process for auditors of public companies and auditors of nonpublic companies.; 01-06 Contrast the various types of audits and types of auditors.

Bloom's: Remember

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

52) Issue CPA certificates.

Answer: State Boards of Accountancy.

Difficulty: 2 Medium

Topic: Financial Statement Audits; Public Accounting Profession

Learning Objective: 01-07 Explain the regulatory process for auditors of public companies and auditors of nonpublic companies.; 01-06 Contrast the various types of audits and types of auditors.

Bloom's: Remember

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

53) Prepares the CPA exam.

Answer: American Institute of Certified Public Accountants.

Difficulty: 2 Medium

Topic: Financial Statement Audits; Public Accounting Profession

Learning Objective: 01-07 Explain the regulatory process for auditors of public companies and auditors of nonpublic companies.; 01-06 Contrast the various types of audits and types of auditors.

Bloom's: Remember

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

54) The Sarbanes-Oxley Act of 2002 made significant reforms for public companies and their auditors.

a. Describe the events that led up to the passage of the Act.

b. Describe the major changes made by the Act.

Answer:

a. The events leading up to the passage of the Sarbanes-Oxley Act include:

* A large number of misstatements of financial statements, many of which resulted from fraudulent financial reporting. Notably including WorldCom and Enron.
* The conviction of the Big 5 accounting firm of Arthur Andersen on charges of destroying evidence.

b. The major reforms made the Act include:

* Tougher penalties for fraud.
* Restrictions on the types of consulting services that may be provided by auditors to their public audit clients.
* The creation of the Public Company Accounting Oversight Board to establish auditing standards and oversee accounting firms that audit public companies.
* Requirements for management to make a assertion about the effectiveness of internal control.
* Requirements for auditors of public companies to audit and report on internal control.

Difficulty: 3 Hard

Topic: Financial Statement Audits

Learning Objective: 01-06 Contrast the various types of audits and types of auditors.; 01-05 Describe how the credibility of the accounting profession was affected by the large number of companies reporting accounting irregularities in the beginning of this century.

Bloom's: Understand

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

55) Many people confuse the responsibilities of the independent auditors and the client's management with respect to audited financial statements.

a. Describe management's responsibility regarding audited financial statements.

b. Describe the independent auditors' responsibility regarding audited financial statements.

c. Evaluate the following statement: "If the auditors disagree with management regarding an accounting principle used in the financial statements, the auditors should express their views in the notes to the financial statements."

Answer:

a. Management has primary responsibility for the fairness of the financial statements and internal control.

b. The auditors are responsible for performing an independent audit of the financial statements and issuing a report on them in accordance with generally accepted auditing standards.

c. The statement if false. The notes to the financial statements should contain only representations of management. The auditors should express their reservations in their report.

Difficulty: 2 Medium

Topic: The Attest Function

Learning Objective: 01-02 Identify assurance services that involve attestation.

Bloom's: Remember

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

56) An investor is considering investing in one of two companies. The companies have very similar reported financial position and results of operations. However, only one of the companies has its financial statements audited.

a. Describe what creates the demand for an audit in this situation. Include a discussion of how audited financial statements facilitate this investment transaction, and the effect of the audit on business risk and information risk.

b. Identify the potential consequences to the company of not having its financial statements audited.

Answer:

a. Audits add credibility to the financial statements of the company. The individual can invest in the company knowing that there is a low probability that the financial statements depart materially from generally accepted accounting principles. Audited financial statements facilitate this transaction by reducing risk related to the investment. Specifically, audits reduce information risk-the risk that information used to make the investment decision is misstated-related to the financial statements. Audited financial statements do not directly affect business risk, which is the risk that the company will not be able to meet its financial obligations.

b. The potential consequences of not having an audit are:

* If the investor is particularly risk averse, he or she may not invest in the company at all.
* If the investor decides to invest in the company, he or she will not be willing to pay as high a price because the investor will want to be compensated for the additional risk that is involved in relying upon unaudited financial statements.

Difficulty: 2 Medium

Topic: Financial Statement Audits

Learning Objective: 01-04 Explain why audits are demanded by society.

Bloom's: Remember

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation