**Chapter 15 Other Assurance Services**

**MULTIPLE CHOICE:**

1. A study and evaluation of internal control made in

 connection with an annual audit is usually not sufficient

to express an opinion on an entity's internal control because

 a. Weaknesses in the system may go unnoticed during the

 audit engagement. b. A study and evaluation of internal control is not necessarily made during an audit engagement. c. Only those controls of interest to the auditor are reviewed, tested, and evaluated. d. Internal controls can change each year.

 ANSWER: C

2. Of the following statements, which one does not describe a distinction between the auditing standards and the attestation standards?

a. Unlike the auditing standards, the attestation standards do not require the auditor to obtain an understanding of the client's internal control system

b. The attestation standards are broader in coverage than the auditing standards.

c. In performing an attest engagement, the CPA need not be independent.

d. In an attest engagement, unlike an audit, generally accepted accounting principles are not the standard used to measure the reasonableness of assertions.

 ANSWER: C

3. Each page of a non-public entity's financial statements reviewed by an accountant should include the following reference:

 a. See Accountant's Review Report. b. Reviewed, No Accountant's Assurance Expressed. c. See Accompanying Accountant's Footnotes. d. Reviewed, No Material Modifications Required.

 ANSWER: A

4. A CPA may accept an engagement to apply agreed-upon procedures to prospective financial statements provided

a. All parties have agreed on the procedures to be applied.

b. The CPA has previously audited the entity for which the agreed-upon procedures are to be applied.

c. Users have participated in establishing the nature and scope of the engagement, distribution of the report is limited to the users involved, and the prospective statements include a summary of significant assumptions.

d. The set of agreed-upon procedures include, at a minimum, a study and evaluation of the existing internal control.

 ANSWER: C

5. The statement that "nothing came to our attention which would indicate that these statements are not fairly presented" expresses which of the following?

 a. Disclaimer of an opinion. b. Negative assurance. c. Negative confirmation. d. Piecemeal opinion.

 ANSWER: B

6. Which of the following is not a distinction between a compilation and a review?

a. The CPA must be independent as a prerequisite to performing a review engagement, but need not be independent to perform a compilation.

b. In conducting a review, the CPA must obtain an understanding of the client's internal control system; but this is not necessary for a compilation engagement.

c. Analytical procedures are applied in a review engagement, but are not required in a compilation.

d. A compilation offers no assurance, whereas a review provides limited assurance.

 ANSWER: B

7. During a compilation of a non-public entity's financial statements, an accountant would be least likely to

 a. Omit substantially all of the disclosures required by generally accepted accounting principles. b. Issue a compilation report on one or more, but not

all, of the basic financial statements. c. Perform analytical procedures designed to identify relationships that appear to be unusual. d. Read the compiled financial statements and consider whether they appear to include adequate disclosure.

 ANSWER: C

8. When an independent CPA is associated with the financial statements of a publicly held entity but has not audited or reviewed such statements, the appropriate form of report to be issued must include a(an)

 a. Compilation report. b. Disclaimer of opinion. c. Unaudited association report.

 d. Qualified opinion.

 ANSWER: B

9. When an auditor issues an unqualified opinion on an entity's internal control, it is implied that the

a. Entity has not violated provisions of the Foreign Corrupt Practices Act. b. Likelihood of management fraud is minimal.

 c. Financial records are sufficiently reliable to permit the preparation of financial statements. d. Entity's internal control system is in conformity with criteria established by its audit committee.

 ANSWER: C

10. Which of the following statements best distinguishes a forecast from a projection?

a. A forecast contains one or more hypothetical

 assumptions, whereas a projection reflects conditions expected to exist.

b. A projection is appropriate for general distribution to third parties, whereas a forecast is more tentative and should be restricted to those parties with whom the client is negotiating directly.

c. The CPA may review a financial forecast, but may only compile a projection.

d. A forecast reflects conditions expected to exist, whereas a projection presents financial position, results of operations, and cash flows given one or more hypothetical assumptions.

 ANSWER: D

1. If an accountant concludes that unaudited financial

 statements on which the accountant is disclaiming an

 opinion also lack adequate disclosure, the accountant

 should suggest appropriate revision. If the client does

 not accept the accountant's suggestion, the accountant

 should

 a. Issue an adverse opinion and describe the appropriate revision in the report. b. Make reference to the appropriate revision and issue a modified report expressing limited assurance. c. Describe the appropriate revision to the financial statements in the accountant's disclaimer of opinion.

 d. Accept the client's inaction because the statements are unaudited and the accountant has disclaimed an opinion.

 ANSWER: C

12. An accountant who reviews the financial statements of a non-public entity should issue a report stating that a review

 a. Is substantially less in scope than an audit. b. Provides negative assurance that the internal control system is functioning as designed. c. Provides only limited assurance that the financial statements are fairly presented. d. Is substantially more in scope than a compilation.

 ANSWER: A

13. Which of the following should not be included in an accountant's standard report based upon the compilation of an entity's financial statements?

a. A statement that a compilation is limited to presenting in the form of financial statements information that is the representation of management.

b. A statement that the compilation was performed in accordance with standards established by the American Institute of CPAs.

c. A statement that the accountant has not audited or reviewed the financial statements.

d. A statement that the accountant does not express an opinion but expresses only limited assurance on the financial statements.

ANSWER: D

14. Of the following statements, which one is not a precondition for performing attest services?

a. The practitioner must be a certified public accountant.

b. The practitioner must have adequate knowledge of the subject matter.

c. There are reasonable measurement and disclosure criteria concerning the subject matter.

d. The assertions are capable of reasonably consistent estimation or measurement using such criteria.

 ANSWER: A

15. In which of the following reports should a CPA not express negative or limited assurance?

 a. A standard compilation report on financial statements of a non-public entity. b. A standard review report on financial statements of a non-public entity. c. A standard review report on interim financial statements of a public entity. d. A standard comfort letter on financial information included in a registration statement of a public entity.

 ANSWER: A

16. In accordance with SEC requirements, a publicly held company has included interim financial information in its annual report to shareholders. The independent auditor has examined the annual financial statements and believes that they fairly present financial position, results of operations, and cash flows. The auditor, however, has not applied limited procedures to the interim data. In drafting the audit report covering the annual financial statements, therefore, the independent auditor should

a. Qualify the audit opinion for a scope limitation, given failure to apply the limited procedures.

b. Issue an unqualified opinion on the financial statements followed by an explanatory paragraph stating that the procedures were not applied.

c. Disclaim an opinion given the material impact of the interim financial information.

d. Qualify the audit opinion and describe the limited procedures in a separate paragraph explaining the scope restriction.

 ANSWER: B

17. Comfort letters are ordinarily signed by the

 a. Client. b. Client's lawyer. c. Independent auditor. d. Internal auditor.

 ANSWER: C

18. Before performing a review of a non-public entity's financial statements, an accountant should

 a. Complete a series of inquiries concerning the entity's procedures for recording, classifying, and summarizing transactions. b. Apply analytical procedures to provide limited assurance that no material modifications should be made to the financial statements. c. Obtain a sufficient level of knowledge of the accounting principles and practices of the industry in which the entity operates.

 d. Inquire whether management has omitted substantially all of the disclosures required by generally accepted accounting principles.

 ANSWER: C

19. The objective of a review of interim financial information is to provide the accountant with a basis for reporting whether

 a. A reasonable basis exists for expressing an updated opinion regarding the financial statements that were previously audited. b. Material modifications should be made to conform with generally accepted accounting principles. c. The financial statements are presented fairly in accordance with standards of interim reporting. d. The financial statements are presented fairly in accordance with generally accepted accounting principles.

 ANSWER: B

20. Which of the following procedures is not necessary in conducting a review of interim financial information?

a. Inquiry concerning the accounting system and any changes in internal control.

b. Application of analytical procedures to the interim information.

c. Inquiry of and obtaining written representations from management concerning its responsibility for the financial information and other matters.

d. Confirmation of significant customer accounts receivable as of the interim balance sheet date.

 ANSWER: D

21. The accountant's report expressing an opinion on an entity's internal control would not include a

 a. Brief explanation of the broad objectives and inherent limitations of internal control. b. Specific date that the report covers, rather than a period of time. c. Statement that the entity's control system is consistent with that of the prior year after giving effect to subsequent changes. d. Description of the scope of the engagement.

 ANSWER: C

22. Comfort letters are ordinarily addressed to

 a. The Securities and Exchange Commission. b. Underwriters of securities. c. Creditor financial institutions. d. The client's audit committee.

 ANSWER: B

23. Which of the following should be included in an accountant's standard report based upon the review of a non-public entity's financial statements?

 a. A statement that the review was performed in accordance with generally accepted review standards.

 b. A statement that a review consists principally of inquiries and analytical procedures. c. A statement that the accountant is independent with respect to the entity. d. A statement that a review is substantially greater in scope than a compilation.

 ANSWER: B

24. Engagements for the purpose of expressing an opinion on internal control differ from the CPA's evaluation of internal control as part of a financial audit in that

a. In an engagement to express an opinion, the CPA is examining and reporting on controls as of a specified date, whereas in conducting a financial audit, the CPA frequently tests controls for effectiveness over the period covered by the financial statements.

b. In conducting a financial statement audit, the CPA expresses an opinion as to the operating effectiveness of the client's internal control system, whereas in an engagement to express an opinion on internal control, the CPA addresses design and implementation of control structure.

c. In conducting a financial statement audit, the CPA is concerned with general controls only, whereas in an engagement to express an opinion on internal control, the CPA tests both general and application controls.

d. Scope limitations that affect a financial audit are irrelevant in an engagement to express an opinion on internal control.

 ANSWER: A

25. Each page of the financial statements compiled by an accountant should include a reference such as

 a. See accompanying accountant's footnotes. b. Unaudited, see accountant's disclaimer. c. See accountant's compilation report. d. Subject to compilation restrictions.

 ANSWER: C

26. The CPA is asked to audit financial statements prepared on a modified cash basis. This is acceptable provided the CPA

a. Converts the financial statement to an accrual basis before rendering an audit report.

b. Qualifies the audit opinion for a departure from GAAP.

c. Issues an adverse opinion.

d. States clearly in the audit report that fairness was evaluated within the framework of the other basis rather than GAAP.

 ANSWER: D

27. A modification of the CPA's report on a review of the interim financial statements of a publicly-held company would be necessitated by which of the following?

 a. An uncertainty. b. Lack of consistency. c. Reference to another accountant. d. Inadequate disclosure.

 ANSWER: D

28. Accepting an engagement to compile a financial projection for a publicly held company most likely would be inappropriate if the projection were to be distributed to

1. A bank with which the entity is negotiating for a loan.

b. A labor union with which the entity is negotiating a contract. c. The principal stockholder, to the exclusion of the other stockholders. d. All stockholders of record as of the report date.

 ANSWER: D

29. When an independent accountant issues a comfort letter to an underwriter containing comments on data that have not been audited, the underwriter most likely will receive

 a. A disclaimer on prospective financial statements. b. A limited opinion on "pro forma" financial statements. c. Positive assurance on supplementary disclosures. d. Negative assurance on capsule information.

 ANSWER: D

30. Which of the following professional services would be considered an attest engagement?

a. A management consulting engagement to provide CBIS advice to a client. b. An engagement to report on compliance with statutory requirements. c. An income tax engagement to prepare federal and state tax returns. d. The compilation of financial statements from a

client's accounting records.

 ANSWER: B

31. The accountant's report expressing an opinion on an entity's internal control should state that the

a. Establishment and maintenance of internal control is the responsibility of management. b. Objectives of the client's internal control are being met. c. Study and evaluation of internal control was conducted in accordance with generally accepted auditing standards. d. Inherent limitations of the client's internal control structure were examined.

 ANSWER: A

32. Which of the following procedures would most likely be included in a review engagement of a non-public entity?

 a. Preparing a bank transfer schedule. b. Inquiring about related party transactions. c. Assessing the internal control structure. d. Performing cutoff tests on sales and purchases transactions.

 ANSWER: B

33. An accountant should not submit unaudited financial statements to the management of a non-public company unless, at a minimum, the accountant

 a. Assists in adjusting the books of account and prepares the trial balance. b. Types or reproduces the financial statements on plain paper. c. Complies with the standards applicable to compilation engagements. d. Applies analytical procedures to the financial statements.

 ANSWER: C

34. A CPA in public practice must be independent in fact and appearance when providing which of the following services?

 Compilation Compilation

 Preparation of a of personal

 of a financial financial

 tax return forecast statements

 \_\_\_\_\_\_\_\_\_\_\_\_ \_\_\_\_\_\_\_\_\_\_\_\_ \_\_\_\_\_\_\_\_\_\_\_\_\_\_

a. Yes No No b. No Yes No c. No No Yes d. No No No

 ANSWER: D

**COMPLETION:**

35. The two levels of attestation are assurance and

 assurance.

 ANSWER: POSITIVE, NEGATIVE

36. Unlike a compilation, a review report includes, after the disclaimer, a paragraph expressing on the financial statements.

 ANSWER: LIMITED (NEGATIVE) ASSURANCE

37. Another term for limited assurance is assurance.

 ANSWER: NEGATIVE

1. A CPA’s expression of an opinion on the effectiveness of a client’s internal control system is known as \_\_\_\_\_\_\_\_\_\_ attestation.

ANSWER: DIRECT

1. A CPA’s expression of an opinion on management’s assertions as to the effectiveness of a client’s internal control system is known as \_\_\_\_\_\_\_\_\_\_\_\_\_\_ attestation.

ANSWER: INDIRECT

1. A report covering the application of agreed-upon procedures

 an on the financial statements because

 the procedures are less extensive than those applied in an

 audit.

 ANSWER: DISCLAIMS, OPINION

41. If procedures have been applied to unaudited data, the CPA may give in the comfort letter to underwriters of proposed securities issues.

 ANSWER: LIMITED, NEGATIVE ASSURANCE

42. The requires that public companies establish and maintain adequate systems of internal control.

 ANSWER: FOREIGN CORRUPT PRACTICES ACT OF 1977

43. If interim financial information which has been reviewed is presented alone, rather than in an unaudited footnote to the annual financial statements, a report must accompany the statements.

 ANSWER: REVIEW

44. An examination of prospective financial statements, like an audit, requires a form of .

 ANSWER: ATTESTATION (OPINION)

**MATCHING:**

45. Select the term that best fits the listed definition.

A. Review

B. Assertion

C. Forecast

D. Compilation

E. Prospective financial statements

F. Projection

G. Agreed-upon procedures engagement

H. Assurance services

I. Compliance attestation

J. Negative assurance

K. Attestation

\_\_\_\_1. The CPA presents information that is the representation of management without undertaking to express any assurance on the statements.

\_\_\_\_2. Independent professional services that improve the quality of information, or its context, for decision makers.

\_\_\_\_3. A disclaimer of opinion followed by a statement that nothing came to the CPA’s attention indicating that the financial statements were not in conformity with GAAP.

\_\_\_\_4. More extensive than a compilation but less so than an audit.

\_\_\_\_5. The resulting report is in the form of procedures applied and findings.

\_\_\_\_6. Results in a written communication that expresses a conclusion about the reliability of a written assertion that is the responsibility of another party.

\_\_\_\_7. Any declaration, or set of related declarations taken as a whole, by a party responsible for it.

\_\_\_\_8. Assurance regarding an entity’s conformity with specified laws, regulations, rules, contracts, or grants.

\_\_\_\_9. Future-oriented financial statements.

\_\_\_\_10. Presents the entity’s expected financial position, results of operations, and cash flows reflecting conditions expected to exist.

SOLUTION:

1. D

2. H

3. J

4. A

5. G

6. K

7. B

8. I

9. E

10. C

**PROBLEM/ESSAY**

1. For each of the following engagements, indicate the nature of the service performed (i.e., audit, review, compilation, etc.), the standards covering the engagement (i.e., auditing, attestation, or accounting and review), the type of report to be issued (i.e., opinion, review, compilation), the level of assurance provided, and the principal procedures to be applied.

A. Kramer.com, a publicly-held company, has requested

 Doom & Gloom, CPAs, to review its quarterly financial

 statements presented to the company’s stockholders.

B. Brewers Investment Consortium has requested Crocker &

 Benson, CPAs to apply certain procedures to a financial projection submitted by Stevens Developers as part of a loan application relative to a new river

 front development project under consideration.

C. Gray Ltd., a small auto repair facility requested

 Holly Lance, CPA, to prepare a set of financial

 statements from the company’s records. Third/Fifth

 Bank has requested the statements as part of a loan

 application submitted by Gray.

 D. Morley Distributors has requested Dolores Del Rio, CPA, to perform necessary procedures for determining

 conformity to a royalty contract granting Morley 1.5%

 of all domestic sales of its franchised distributors.

SOLUTION:

A. Nature of service: Review of interim financial information

 Applicable standards: Auditing standards

 Type of report: Review report

 Level of assurance: Limited or negative

 Principal procedures: Inquiry and analytical

 procedures

B. Nature of service: Prospective financial statements

 Applicable standards: Attestation standards

 Type of report: Agreed-upon procedures report

 Level of assurance: None

 Principal procedures: As agreed (inquiry, testing

 assumptions for reasonableness)

C. Nature of service: Compilation of financial

 statements for a nonpublic

 entity

 Applicable standards: Accounting and review

 Type of report: Compilation report

 Level of assurance: None

 Principal procedures: Understand industry accounting

 practices

 Read the financial statements

D. Nature of service: Compliance attestation

 Applicable standards: Attestation standards

 Type of report: Agreed-upon procedures report

 Level of assurance: None

 Princpal procedures: As agreed (inquiry, reading royalty agreement, recomputing

 royalty amounts)

1. You have been asked by Kromley’s Recreation and Fitness

Center to review its financial statements for the year ending December 31, 2002. Kromlely’s has requested a substantial loan from Renters Life & Casualty Insurance Ltd. The loan proceeds will be used to construct a second facility in the western suburbs of the city. In the past you

have compiled Kromley’s financial statements, but have never audited or reviewed them.

 *Required*:

 a. Differentiate among audits, reviews, and compilations in terms of procedures to be applied and level of assurance provided.

 b. Assuming you completed your field work on February 14, 2003 and do not find any material cause for modification of the financial statements, draft the review report.

1. Assume that you discover that Kromley has not

 recognized any asset or liability for a material

 financing-type lease. What modifications should you

 make to the standard review report?

1. What should you do if management and the board do not

 agree to these modifications?

SOLUTION:

 a. Compilation Review Audit

Procedures Inquiry Inquiry Study and evaluate internal

 Read financial Read financial control

 statements statements Observe

 Apply analytical Confirm

 procedures Examine

 Calculate

 Inspect

 Vouch

Level of assurance None Limited Positive

b.

To the Board of Directors of Kromley’s Recreation and Fitness Center:

 We have reviewed the accompanying balance sheet of Kromley’s Recreation and Fitness Center as of December 31, 2002, and the related statements of income, retained earnings, and cash flows for the year then ended, in accordance with standards established by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of the management of Kromley Recreation and Fitness Center.

 A review consists principally of inquiries of company personnel and analytical procedures applied to financial data. It is substantially less in scope than an examination in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

 Based on our review, we are not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with generally accepted accounting principles.

Student’s Name, CPA

February 14, 2003

c.

 1. This departure from GAAP should be identified in the third paragraph and explained in a separate fourth paragraph of the review report as follows:

 As disclosed in Note X to the financial statements, generally accepted accounting principles require that financing leases be included on the balance sheet as part of property, plant, and equipment, and also as a long-term liability at the present value of such obligations. Management has informed us that the company accounts for these costs as they are disbursed to the lessor. The effects of this departure from generally accepted accounting principles on financial position, results of operations, and cash flows have not been determined.

 2. If management and the board do not agree to the above modification, you should refuse to be associated with the financial statements.