**Chapter 25 Auditing Theory**

Multiple-Choice Questions

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 1.  easy  d | The standards which govern the CPA’s association with unaudited financial statements of private companies are the:  a. AICPA’s *Code of Professional Conduct.*  b. Statements on Auditing Standards (SASs).  c. Statements of Standards on Attestation Engagements (SSAEs).  d. Statements on Standards for Accounting and Review Services (SSARS). | | | | | | | | | | | | | | |
| 2.  easy  b | The two types of services provided in connection with the Statements on Standards for Accounting and Review Services are:  a. audit and examination services.  b. compilation and review services.  c. examination and review services.  d. management advisory services and compilations. | | | | | | | | | | | | | | |
| 3.  easy  c | Statements on Standards for Attestation Engagements are established by the:  a. Securities and Exchange Commission.  b. Public Company Accounting Oversight Board.  c. Auditing Standards Board.  d. Accounting and Review Services Committee. | | | | | | | | | | | | | | |
| 4.  easy  c | Because the same CPA firm does both the annual audit and the public company interim financial statement review, they are referred to as \_\_\_\_\_\_\_.  a. bookkeepers  b. accountants  c. auditors  d. CPAs | | | | | | | | | | | | | | |
| 5.  easy  b | Practitioners who perform reviews and compilations are referred to in the SSARS standards as:  a. bookkeepers.  b. accountants.  c. auditors.  d. CPAs. | | | | | | | | | | | | | | |
| 6.  easy  c | A(n) \_\_\_\_\_\_\_ results in a conclusion that represents positive assurance.  a. review  b. compilation  c. examination  d. agreed upon procedure engagement | | | | | | | | | | | | | | |
| 7.  easy  a | Compilation reports may be of all but which of the following types?  a. Compilation with limited independence.  b. Compilation with full disclosure  c. Compilation without independence.  d. Compilation that omits substantially all disclosures. | | | | | | | | | | | | | | |
| 8.  easy  c | An examination results in a conclusion that represents \_\_\_\_\_\_\_ assurance.  a. limited assurance  b. negative  c. positive  d. unequivocal | | | | | | | | | | | | | | |
| 9.  easy  d | A CPA firm can issue a compilation report:  a. only if the partners are independent.  b. only if all the partners and the staff in the office performing the engagement are independent.  c. if the partners have no material or direct immaterial interest in client.  d. even if it is not independent. | | | | | | | | | | | | | | |
| 10.  easy  b | Which of the following meets the attestation standards’ definition of an examination?  a. Preparing a corporation’s annual tax returns.  b. An audit of the financial statements.  c. A review of the financial statements.  d. A compilation of the financial statements. | | | | | | | | | | | | | | |
| 11.  easy  a | Which of the following would not be included in a CPA’s report based upon a review of the financial statements of a nonpublic entity?  a. A statement that the review was in accordance with generally accepted auditing standards.  b. A statement that all information included in the financial statements is the representation of management.  c. A statement describing the principal procedures performed.  d. A statement describing the auditor’s conclusions based upon the results of the review. | | | | | | | | | | | | | | |
| 12.  easy  a | The distribution of which of the following types of reports is unrestricted?  a. Examinations and reviews  b. Reviews and agreed-upon procedures  c. Examinations and agreed-upon procedures  d. Examinations, reviews, and agreed-upon procedures | | | | | | | | | | | | | | |
| 13.  easy  b | 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. Shared opinion. | | | | | | | | | | | | | | |
| 14. | For reviews, an accountant does which of the following? | | | | | | | | | | | | | | |
| easy  d |  | | Obtain an understanding of internal control. | | | |  | | Perform tests of controls. | |  | Perform tests of transactions. | |
|  | a. | | Yes | | | |  | | Yes | |  | No | |
|  | b. | | Yes | | | |  | | No | |  | Yes | |
|  | c. | | No | | | |  | | Yes | |  | Yes | |
|  | d. | | No | | | |  | | No | |  | No | |
|  |  | | | | | | | | | | | | | | |
| 15.  easy  b | An auditor who conducts an examination in accordance with generally accepted auditing standards and concludes that the financial statements are fairly presented in accordance with a comprehensive basis of accounting other than GAAP, should issue a:  a. review report.  b. special report.  c. qualified opinion.  d. disclaimer of opinion. | | | | | | | | | | | | | | |
| 16.  medium  d | Specific attestation standards have been developed in all but which of the following areas?  a. Pro forma financial information.  b. Compliance with laws and regulations.  c. Prospective financial statements.  d. Standards have been developed for all of the above. | | | | | | | | | | | | | | |
| 17.  medium  a | Reports on agreed-upon procedures are intended to be distributed:  a. to only the involved parties, who would have the requisite knowledge about those procedures and the level of assurance resulting from them.  b. to only the involved parties, who would have the requisite knowledge about those procedures but not the level of assurance resulting from them.  c. to any party to whom the client wishes.  d. only to the stockholders of the client. | | | | | | | | | | | | | | |
| 18.  medium  a | Which of the following is not an area of emphasis in a review conducted under the SSARS?  a. Tests of internal controls.  b. Make inquiries of management.  c. Obtain knowledge of the client.  d. Obtain knowledge of the accounting principles and practices of the client’s industry. | | | | | | | | | | | | | | |
| 19.  medium  c | Distribution of which of the following types of reports is limited?  a. Audit  b. Review  c. Agreed-upon procedures  d. Examination | | | | | | | | | | | | | | |
| 20.  medium  c | In which type of report would you read the following statement: “We believe that our examination provides a reasonable basis for our opinion.”?  a. Review  b. Audit  c. Examination  d. Agreed-upon procedures | | | | | | | | | | | | | | |
| 21.  medium  a | Which of the following forms of review are permissible under SSARS?  a. Review without positive assurance.  b. Review on financial statements that omit substantially all disclosures.  c. Reviews without CPA independence.  d. Review without limited procedures. | | | | | | | | | | | | | | |
| 22.  medium | Evidence for a review engagement consists primarily of: | | | | | | | | | | | | | | |
| a |  | Inquiries | |  | Analytical procedures | | | | | Tests of details | | | | |
|  | a. | No | |  | Yes | | | | | No | | | | |
|  | b. | Yes | |  | Yes | | | | | No | | | | |
|  | c. | No | |  | No | | | | | Yes | | | | |
|  | d. | Yes | |  | No | | | | | Yes | | | | |
|  |  | | | | | | | | | | | | | | |
| 23.  medium | Which of the following services is performed under the attestation standards? | | | | | | | | | | | | | | |
| a |  | WebTrust | | | |  | | SysTrust | | | | |
|  | a. | Yes | | | |  | | Yes | | | | | | | |
|  | b. | No | | | |  | | No | | | | | | | |
|  | c. | Yes | | | |  | | No | | | | | | | |
|  | d. | No | | | |  | | Yes | | | | | | | |
|  |  | | | | | | | | | | | | | | |
| 24. (Public)  medium  b | The Securities and Exchange Commission requires quarterly financial information as a part of the:  a. 10-K report.  b. 10-Q report.  c. 8-K report.  d. auditor’s report. | | | | | | | | | | | | | | |
| 25. (Public)  medium  d | The quarterly reports submitted to the SEC by the client:  a. have to be audited and the CPA firm must be identified.  b. do not have to be audited, but the CPA firm which does the year-end audit must be identified.  c. have to be audited, but the CPA firm does not have to be identified.  d. do not have to be audited, but the CPA firm which does the year-end audit must review the quarterly statements before they are submitted to the SEC. | | | | | | | | | | | | | | |
| 26.  medium  d | The WebTrust service requires that a CPA update its testing of the e-commerce aspects of a entity’s Web site at least every:  a. ninety days.  b. month.  c. six months.  d. twelve months. | | | | | | | | | | | | | | |
| 27.  medium  b | Reports on debt compliance and similar engagements may be issued as a separate report or as part of a report that expresses the auditor’s opinion on the financial statements. When they are issued as a part of the report on the financial statements, it is done by:  a. adding a middle paragraph before the opinion paragraph.  b. adding a paragraph after the opinion paragraph.  c. adding an additional phrase or sentence within the opinion paragraph.  d. adding a paragraph between the introductory and scope paragraphs. | | | | | | | | | | | | | | |
| 28.  medium  a | Auditors frequently audit statements that were prepared on a comprehensive basis of accounting other than GAAP. When this occurs:  a. generally accepted auditing standards apply to these engagements and the reporting requirements differ.  b. generally accepted auditing standards apply to these engagements and the reporting requirements are the same as well.  c. generally accepted auditing standards do not apply to these examinations and the reporting requirements differ also.  d. generally accepted auditing standards do not apply to this engagement and the reporting requirements remain the same for the CPA. | | | | | | | | | | | | | | |
| 29.  medium  d | Which of the following is not a standard contained in both the Statement on Standards for Attestation Engagements and the Statement on Auditing Standards?  a. The examination is to be performed by a person having adequate technical training.  b. An independence in mental attitude is to be maintained.  c. Sufficient evidence is to be obtained.  d. The practitioner must obtain a sufficient understanding of the client’s internal control. | | | | | | | | | | | | | | |
| 30.  medium  b | Which of the following is not one of the types of engagements and related forms of conclusions that are defined by the attestation standards?  a. Reviews.  b. Compilations.  c. Examinations.  d. Agreed-upon procedures. | | | | | | | | | | | | | | |
| 31.  medium  a | Which of the following types of engagement reports would provide positive assurance?  a. An examination.  b. A review.  c. An agreed-upon procedures engagement.  d. A compilation. | | | | | | | | | | | | | | |
| 32.  medium  d | Which of the following is not one of the general types of prospective financial statements included in the attestation standards? | | | | | | | | | | | | | | |
|  |  | Forecasts | |  | Projections | | | | | Earnings estimates | | | | |
|  | a. | No | |  | No | | | | | Yes | | | | |
|  | b. | No | |  | Yes | | | | | No | | | | |
|  | c. | Yes | |  | Yes | | | | | No | | | | |
|  | d. | Yes | |  | No | | | | | Yes | | | | |
|  |  | | | | | | | | | | | | | | |
| 33.  medium  c | A report on an examination is \_\_\_\_\_\_\_ as to the distribution by the client after it is issued.  a. restricted  b. limited  c. unrestricted  d. directed | | | | | | | | | | | | | | |
|  |  | | | | | | | | | | | | | | |
| 34.  medium  c | Which are prospective financial statements that present an entity’s expected financial position, results of operations, and cash flows, to the best of the responsible party’s knowledge and belief? | | | | | | | | | | | | | | |
| a |  | Forecasts | | | |  | | Projections | | | | |
|  | a. | Yes | | | |  | | Yes | | | | | | | |
|  | b. | No | | | |  | | No | | | | | | | |
|  | c. | Yes | | | |  | | No | | | | | | | |
|  | d. | No | | | |  | | Yes | | | | | | | |
|  |  | | | | | | | | | | | | | | |
| 35.  medium  d | Which are prospective financial statements that present an entity’s financial position, results of operations, and cash flows, to the best of the responsible party’s knowledge and belief, given one or more hypothetical assumptions? | | | | | | | | | | | | | | |
| a |  | Forecasts | | | |  | | Projections | | | | |
|  | a. | Yes | | | |  | | Yes | | | | | | | |
|  | b. | No | | | |  | | No | | | | | | | |
|  | c. | Yes | | | |  | | No | | | | | | | |
|  | d. | No | | | |  | | Yes | | | | | | | |
| 36.  medium  b | Professional standards prohibit one of the following types of engagements for prospective financial statements from being undertaken.  a. A compilation.  b. A review.  c. An examination.  d. An agreed-upon procedures engagement. | | | | | | | | | | | | | | |
| 37.  medium  b | General use statements are prepared for use by \_\_\_\_\_\_\_\_.  a. known contractual parties  b. any third party  c. regulators  d. internal auditor. | | | | | | | | | | | | | | |
| 38.  medium  c | An agreed-upon procedures engagement is one in which:  a. the auditor and management agree that procedures will be applied to all accounts and circumstances.  b. the auditor and management agree that procedures will not be applied to all accounts and circumstances.  c. the auditor and management or a third party agree that the engagement will be limited to certain specific procedures.  d. the auditor and management or a 3rd party agree that the auditor will apply his or her judgment to determine procedures to be performed. | | | | | | | | | | | | | | |
| 39.  medium  d | Statements on Accounting and Review Services are issued by the:  a. Auditing Standards Board.  b. Securities and Exchange Commission.  c. Public Company Accounting Oversight Board.  d. Accounting and Review Services Committee of the AICPA. | | | | | | | | | | | | | | |
| 40.  medium  c | Assurance provided by a review is substantially less than an audit. Which of the following statements is true regarding these services?  a. A review requires more substantive evidence than an audit.  b. An audit requires less evidence related to internal control than a review.  c. A review requires less evidence than an audit.  d. None of the above statements is true. | | | | | | | | | | | | | | |
| 41.  medium  c | An accountant who reviews the financial statements of a nonpublic entity should issue a report stating that a review:  a. is substantially equivalent in scope to an audit.  b. is substantially more in scope than a compilation.  c. is substantially less in scope than an audit.  d. provides only limited assurance that the financial statements are fairly presented. | | | | | | | | | | | | | | |
| 42.  medium  d | Which of the following procedures is not included in a review engagement of a nonpublic entity?  a. Inquiries of management.  b. Inquiries regarding events subsequent to the balance sheet date.  c. Any procedures designed to identify relationships among data that appear to be unusual.  d. A study and evaluation of internal control. | | | | | | | | | | | | | | |
| 43.  medium  d | When an accountant performs more than one level of service (for example, a compilation and a review, or a compilation and an audit) concerning the financial statements of a nonpublic entity, the accountant generally should issue the report that is appropriate for:  a. a review engagement.  b. a compilation engagement.  c. the lowest level of service rendered.  d. the highest level of service rendered. | | | | | | | | | | | | | | |
| 44. (Public)  medium  c | The title of a review report issued for a public company’s quarterly financial statements is titled with which of the following?  a. Report of Independent Public Accountants.  b. Report of Independent Auditors.  c. Report of Independent Registered Public Accounting Firm.  d. Report of Certified Public Accountant. | | | | | | | | | | | | | | |
| 45.  medium  d | You are a CPA retained by the manager of a cooperative retirement village to do “write-up work.” You are expected to prepare unaudited financial statements with each page marked “unaudited” and accompanied by a disclaimer of opinion stating no audit was performed. In performing the work, you discover that there are no invoices to support a claim for a $25,000 disbursement. The manager informs you that all the disbursements are proper. What should you do?  a. Submit the expected statements but omit $25,000 of unsupported disbursements.  b. Include the unsupported disbursements in the statements since you are not expected to make an audit.  c. Obtain from the manager a written statement that you informed him of the missing invoices and include his assurance that the disbursements are proper.  d. Notify the owners that some of the claimed disbursements are unsupported and withdraw if the situation is not satisfactorily resolved. | | | | | | | | | | | | | | |
| 46.  medium  c | Debt compliance letters are ordinarily addressed to:  a. underwriters of securities.  b. the client’s audit committee.  c. creditor financial institutions.  d. the Securities and Exchange Commission. | | | | | | | | | | | | | | |
| 47.  medium  c | Why do standards prohibit accepting an engagement on a projection for general use?  a. The CPA’s procedures would violate SSARS.  b. Reports on projections are not well understood by the general public.  c. Underlying hypothetical assumptions are difficult to interpret without obtaining additional information.  d. The CPA is not qualified to report on the use of GAAP in the projected financial statement. | | | | | | | | | | | | | | |
| 48.  medium  b | Which of the following is not an element of examining a forecast?  a. Evaluating the preparation of the prospective financial statements.  b. Understanding internal controls.  c . Evaluating the support underlying the assumptions.  d. Issuing an examination report. | | | | | | | | | | | | | | |
| 49.  medium  a | An accountant may accept an engagement to apply agreed-upon procedures to prospective financial statements provided that:  a. distribution of the report is to be restricted to the specified users involved.  b. the prospective financial statements are also examined.  c . responsibility for the adequacy of the procedures performed is taken by the accountant.  d. negative assurance is expressed on the prospective financial statements taken as a whole. | | | | | | | | | | | | | | |
| 50.  medium  b | Non-accounting data included in a long-form report have been subjected to auditing procedures. The auditor’s report should state this fact and should explain that the non-accounting data are presented for analysis purposes. In addition, the auditor’s report should state whether the non-accounting data are:  a. audited, unaudited, or reviewed on a limited basis.  b. fairly stated in all material respects in relation to the basic financial statements taken as a whole.  c. beyond the scope of the normal engagement and therefore, not covered by the opinion on the financial statements.  d. within the framework of generally accepted auditing standards, which apply to the financial statements taken as a whole. | | | | | | | | | | | | | | |
| 51.  medium  a | An auditor has been asked to report on the balance sheet of Kane Company but not on the other basic financial statements. The auditor will have access to all information underlying the basic financial statements. Under these circumstances, the auditor:  a. may accept the engagement because such engagements merely involve limited reporting objectives.  b. may accept the engagement but should disclaim an opinion because of an inability to apply the procedures considered necessary.  c. should refuse the engagement because there is a client-imposed scope limitation.  d. should refuse the engagement because of a departure from generally accepted auditing standards. | | | | | | | | | | | | | | |
| 52.  medium  a | A CPA who has been engaged to audit financial statements that were prepared on a cash basis:  a. must ascertain that there is proper disclosure of the fact that the cash basis has been used, the general nature of material items omitted, and the net effect of such omissions.  b. may not be associated with such statements which are not in accordance with generally accepted accounting principles.  c. must render a qualified report explaining the departure from generally accepted accounting principles in the opinion paragraph.  d. must restate the financial statements on an accrual basis and then render the standard (short-form) report. | | | | | | | | | | | | | | |
| 53.  challenging  b | One example of a “special report,” as defined by Statements on Auditing Standards, is a report issued in connection with:  a. a feasibility study.  b. price-level basis financial statements.  c. a limited review of interim financial information.  d. compliance with a contractual agreement not related to the financial statements. | | | | | | | | | | | | | | |
| 54.  challenging  a | In a review service where the client has failed to follow GAAP, the accountant is:  a. not required to determine the effect of a departure if management has not done so, but that fact must be disclosed in the report.  b. required to determine the effect of a departure if management has not done so, and that fact must be disclosed in the report.  c. not required to determine the effect of a departure if management has not done so, and that fact need not be disclosed in the report.  d. required to determine the effect of a departure if management has not done so, and that fact need not be disclosed in the report. | | | | | | | | | | | | | | |
| 55.  challenging  a | WebTrust engagements should be performed following guidance provided by the:  a. AICPA attestation standards.  b. AICPA auditing standards.  c. AICPA accounting standards.  d. AICPA review standards. | | | | | | | | | | | | | | |
| 56.  challenging  a | The engagement and report on debt compliance letters should be limited to compliance matters that the auditor is qualified to evaluate. Which of the following engagements would be inappropriate for the CPA to attempt to evaluate?  a. Determining whether the client has properly restricted its business activities to the requirements of an agreement.  b. Determining whether principal and interest payments were made when due.  c. Determining whether the proper limitations were maintained on dividends, working capital, and debt ratios.  d. Determining whether the accounting records were adequate for conducting an ordinary audit. | | | | | | | | | | | | | | |
| 57.  challenging  c | Prospective financial statements are for general use or for limited use. General use refers to use by any third party, whereas limited use refers to use by third parties with which the responsible party is negotiating directly. Which of the following statements is not correct?  a. Forecasts can be provided for general use.  b. Forecasts can be provided for limited use.  c. Projections can be provided for general use.  d. Projections can be provided for limited use. | | | | | | | | | | | | | | |
| 58.  challenging  b | Before performing a review of a nonpublic 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. obtain a sufficient level of knowledge of the accounting principles and practices of the industry in which the entity operates.  c. inquire whether management has omitted substantially all of the disclosures required by generally accepted accounting principles.  d. apply analytical procedures to provide limited assurance that no material modifications should be made to the financial statements. | | | | | | | | | | | | | | |
| 59.  challenging  d | An auditor who was engaged to perform an examination of the financial statements of a nonpublic entity has been asked by the client to refrain from performing various audit procedures and change the nature of the engagement to a review of the financial statements in accordance with standards established by the AICPA. The client’s request was made because the cost to complete the examination was significant. Under these circumstances, the auditor would most likely:  a. qualify the auditor’s report and refer to the scope limitation.  b. view the request as an indication of a possible irregularity.  c. complete the examination that was in progress.  d. honor the client’s request. | | | | | | | | | | | | | | |
| 60.  challenging  d | An accountant’s standard report on a compilation of a projection should not include a:  a. statement that a compilation of a projection is limited in scope.  b. separate paragraph that describes the limitations on the presentation’s usefulness.  c. disclaimer of responsibility to update the report for events occurring after the report’s date.  d. statement that the accountant expresses only limited assurance that the results may be achieved. | | | | | | | | | | | | | | |
| 61.  challenging  b | Attestation standards allow a CPA to perform all but which of the following services for a forecast or projection?  a. Compilation  b. Review  c. Examination  d. Agreed-upon procedures | | | | | | | | | | | | | | |
| 62.  challenging  b | Under what standards are WebTrust and SysTrust engagements performed?  a. SSAR  b. SSAE  c. SAS  d. SSARS | | | | | | | | | | | | | | |
| 63.  challenging  c | Negative assurance is not permissible in:  a. reports based upon a review engagement.  b. letters required by security underwriters for data pertinent to SEC registration statements.  c. reports based on an audit of interim financial statements of a closely held business entity.  d. reports relating to the results of agreed-upon procedures to one or more specified elements, accounts, or items of financial statement. | | | | | | | | | | | | | | |
| 64.  challenging  a | The auditor’s best course of action with respect to “other financial information” included in an annual report containing the auditor’s report is to:  a. read and consider the manner of presentation of the “other financial information.”  b. indicate in the auditor’s report that the “other financial information” is unaudited.  c. consider whether the “other financial information” is accurate by performing a limited review.  d. obtain written representations from management as to the accuracy of the “other financial information.” | | | | | | | | | | | | | | |
| 65.  challenging  c | A CPA who is not independent and is associated with financial statements should disclaim an opinion with respect to those financial statements. The disclaimer should:  a. clearly state the specific reasons for lack of independence.  b. not mention any reason for the disclaimer other than that the CPA was unable to conduct the examination in accordance with generally accepted auditing standards.  c. not describe the reason for lack of independence but should state specifically that the CPA is not independent.  d. include a middle paragraph clearly describing the CPA’s association with the client and explaining why the CPA was unable to gather sufficient competent evidential matter to warrant the expression of an opinion. | | | | | | | | | | | | | | |

Essay Questions

|  |  |
| --- | --- |
| 66.  easy | Define forecast and projection. |
|  | Answer:  Forecasts are prospective financial statements that present an entity’s *expected* financial position, results of operations, and cash flows, to the *best* of the responsible party’s knowledge and belief.  Projections are prospective financial statements that present an entity’s financial position, results of operations, and cash flows, to the best of the responsible party’s knowledge and belief, given one or more *hypothetical assumptions*. |
| 67.  easy | What are SSARS and who issues them? |
|  | Answer:  SSARS are Statements on Standards for Accounting and Review Services. They are issued by the Accounting and Review Services Committee of the AICPA. |
| 68.  easy | What are SSAEs and who issues them? |
|  | Answer:  SSAEs are Statements on Standards for Attestation Engagements. They are issued by the Auditing Standards Board. |
| 69.  easy | Who developed the *WebTrust* service? Briefly explain this service. |
|  | Answer:  *WebTrust* was developed jointly by the AICPA and the Canadian Institute of Chartered Accountants. In a *WebTrust* engagement, a client engages a CPA to provide reasonable assurance that the client’s Web site complies with certain *Trust Services* principles and criteria for one or more e-commerce activities. A site that meets the *Trust Service* principles is eligible to display the *WebTrust* seal on its transaction or order page. |
| 70.  medium | A financial statement review conducted in compliance with SSARS emphasizes five activities, one of which is to “perform analytical procedures.” State the other four. |
|  | Answer:   * Obtain knowledge of the accounting principles and practices of the client’s industry. * Obtain knowledge of the client; that is understood, the client’s business transactions, its accounting records and employees, and the basis, form, and content of the financial statements. * Make inquiries of management to determine whether the financial statements are fairly presented. * The accountant is specifically required to obtain a letter of representation from members of management who are knowledgeable about financial matters. |
| 71.  medium | Discuss each of the three types of compilation reports and the circumstances in which each should be used. |
|  | Answer:   * *Compilation with full disclosure.* This report is used when the financial statements include all disclosures required by generally accepted accounting principles. * *Compilation that omits substantially all disclosures.* This type of report is used when the financial statements omit substantially all of the disclosures required by GAAP, and the absence of disclosures is not, to the CPA’s knowledge, undertaken with the intent to mislead users. * *Compilation without independence.* If the accountant is not independent with respect to the client, the compilation report should include, as a separate last paragraph, a statement to that effect. |
| 72.  medium | State four types of assurance services that fall within the auditing standards but are not audits, reviews, or compilations of financial statements in accordance with GAAP. |
|  | Answer:   * Other comprehensive basis of accounting. * Specified elements, accounts, or items. * Information accompanying basic financial statements. * Debt compliance letters and similar reports. |
| 73.  medium | Auditors frequently audit statements prepared on bases other than GAAP. Discuss four commonly used bases other than GAAP. |
|  | Answer:   * *Cash or modified cash basis.* With the cash basis, receipts and disbursements are recorded; there are no accruals. Under the modified cash basis, the cash basis is followed except for certain items, such as recording fixed assets and depreciation. * *Basis used to comply with the requirements of a regulatory agency.* * *Income tax basis.* The same measurement rules used for filing tax returns are often used for financial statement preparation, even though this is not in accordance with generally accepted accounting principles. * *A definite set of criteria having substantial support.* For example, the price-level basis of accounting could be applied to all material items in the financial statements. |
| 74.  medium | Briefly describe a *SysTrust* engagement. |
|  | Answer:  A SysTrust licensed accountant evaluates a company’s computer system using *Trust Services* principles and criteria and determines whether controls over the system exist. The accountant then performs tests to determine whether those controls were operating effectively during a specified period. If the system meets the requirements of the *Trust Services* principles and criteria, an examination-level unqualified attestation report is issued under the AICPA attestation standards. |
| 75.  medium | Frequently, clients request auditors to include additional information beyond the basis financial statements in the set of materials prepared for management or outside users. List three types of additional information commonly included in the additional information section. |
|  | Answer: (students should list three of the five)   * Detailed comparative statements supporting the control totals on the primary financial statements for accounts such as cost of goods sold, operating expenses, and miscellaneous assets. * Supplementary information required by the Financial Accounting Standards Board or Securities and Exchange Commission. * Statistical data for past years in the form of ratios and trends. * A schedule of insurance coverage. * Specific comments on the changes that have taken place in the statements. |
| 76.  challenging | Briefly describe each of the five *Trust Services* principles. |
|  | Answer:  The five *Trust Services* principles are:   1. Online Privacy – personal information obtained as a result of e-commerce is collected, used, disclosed, and retained as committed or agreed. 2. Security – the system is protected against unauthorized access (both physical and logical access). 3. Processing integrity – system processing is complete, accurate, timely, and authorized. 4. Availability – the system is available for operation and use as committed or agreed. 5. Confidentiality – information designated as confidential is protected as committed or agreed. |
| 77.  challenging | Draft a report that would be appropriate when an independent accountant has performed a compilation of financial statements with disclosures in accordance with GAAP. |
|  | Answer:  We have compiled the accompanying balance sheet of XYZ Company as of December 31, 200X, and the related statements of income, retained earnings, and cash flows for the year then ended, in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants.  A compilation is limited to presenting in the form of financial statements information that is the representation of management. We have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or any other form of assurance on them. |
| 78.  challenging | Draft a report that would be appropriate when an accountant has made a proper review of the accounting records and the financial statements of a nonpublic entity and has concluded they appear reasonable. |
|  | Answer:  We have reviewed the accompanying balance sheet of XYZ Company as of December 31, 200X, and the related statements of income, retained earnings, and cash flows for the year then ended, in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of the management of XYZ Company.  A review consists principally of inquiries of company personnel and analytical procedures applied to financial data. It is substantially less in scope than an audit 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. |
| 79.  challenging | Discuss the five SSARS requirements that must be met when an accountant is performing a compilation of financial statements. |
|  | Answer:  The preparer of the statements must:   * Establish an understanding with the client about the type and limitations of the services to be provided and a description of the report, if a report is to be issued. * Possess knowledge about the accounting principles and practices of the client’s industry. * Know the client; understand the nature of the client’s business transactions, accounting records, and employees; and know the content of the financial statements (the knowledge can be less than that for a review). * Make inquiries to determine whether the client’s information is satisfactory. * Read the compiled financial statements and be alert for any obvious omissions or errors in arithmetic and GAAP. |

|  |  |
| --- | --- |
| 80.  challenging | Draft a report that would be appropriate when an independent accountant has performed a compilation of financial statements which substantially omit all disclosures and the statement of cash flows required by GAAP. |
|  | Answer:  We have compiled the accompanying balance sheet of XYZ Company as of December 31, 200X, and the related statements of income, retained earnings, and cash flows for the year then ended, in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants.  A compilation is limited to presenting in the form of financial statements information that is the representation of management. We have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or any other form of assurance on them.  Management has elected to omit substantially all of the disclosures and the statement of cash flows required by generally accepted accounting principles. If the omitted disclosures were included in the financial statements, they might influence the user’s conclusions about the company’s financial position, results of operations, and cash flows. Accordingly, these financial statements are not designed for those who are not informed about such matters. |
| 81.  challenging | Draft a report that would be appropriate when an accountant has performed a compilation of financial statements with disclosures in accordance with GAAP, but the accountant is not independent with respect to the client. |
|  | Answer:  We have compiled the accompanying balance sheet of XYZ Company as of December 31, 200X, and the related statements of income, retained earnings, and cash flows for the year then ended, in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants.  A compilation is limited to presenting in the form of financial statements information that is the representation of management. We have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or any other form of assurance on them.  We are not independent with respect to XYZ Company. |
| 82.  challenging | The format and contents of an audit report for specified elements, accounts, or items is similar to the standard audit report of financial statements in accordance with GAAP. However, it must also reflect four requirements for reporting on specified elements, accounts, or items. State each of these four requirements. |
|  | Answer:   * The specified elements, accounts, or items must be identified. * The basis on which the specified elements, accounts, or items are presented and the agreements specifying the basis must be described. * The source of significant interpretations made by the client about the provisions of a relevant agreement must be indicated and described. * If the specified element, account, or item is presented on a basis that is not in conformity with generally accepted accounting principles or another comprehensive basis of accounting, a paragraph that restricts the distribution of the report to those within the entity and the parties to the contract or agreement must be added. |

Other Objective Answer Format Questions

|  |  |
| --- | --- |
| 83.  medium | Match the type of engagement (a-g) with the source of authoritative support for that engagement provided below (1-7). Sources may be used more than once (or not at all). |
|  | a. Auditing standards |
|  | b. Accounting and review service standards |
|  | c. Auditing standards and governmental auditing standards |
|  | d. Attestation standards |
|  | e. Governmental auditing standards |
|  | f. No standards have been set for these engagements |
|  | g. Standards of the Public Company Accounting Oversight Board |
|  |  |
| b | 1. Compilation of financial statements prepared in accordance with GAAP for a nonpublic company. |
| d | 2. Attestation of forecasted financial statements. |
| f | 3. Operational auditing. |
| g | 4. Review financial statements prepared in accordance with GAAP for a public company. |
| a | 5. Audits of financial statements for a nonpublic entity prepared in accordance with GAAP. |
| c | 6. Governmental auditing. |
| a | 7. Limited assurance engagements other than audits, reviews, or compilations of historical financial statements prepared in accordance with GAAP. |
| 84.  easy  b | Review reports are normally dated as of the client’s balance sheet date.  a. True  b. False |
| 85.  easy  b | SSARS are issued by the SEC.  a. True  b. False |
| 86.  easy  a | A primary concern in reporting on a comprehensive basis is to make sure that the statements clearly indicate that they are prepared on a basis other than GAAP.  a. True  b. False |
| 87.  easy  b | SSAEs are issued by the PCAOB.  a. True  b. False |
| 88.  easy  b | A nonaudit engagement in which the accountant undertakes to present, in the form of financial statements, information that is the representation of management, without undertaking to express any assurance on the statements is called a review engagement.  a. True  b. False |
| 89.  easy  b | CPAs must be independent to issue a compilation report.  a. True  b. False |
| 90.  easy  a | CPAs must be independent to issue a review report.  a. True  b. False |
| 91.  medium  a | When an auditor issues an opinion on additional information accompanying the financial statements, materiality is the same as that used in forming an opinion on the basic financial statements.   1. True 2. False |
| 92.  medium  b | *WebTrust* services are performed under the direction of the SSARS.   1. True 2. False |
| 93.  medium  a | *Systrust* services are performed under the direction of the SSAEs.  a. True  b. False |
| 94.  medium  b | A financial statement review conducted in compliance with SSARS includes obtaining an understanding of internal control.  a. True  b. False |
| 95.  medium  a | Statements on Standards for Accounting and Review Services (SSARS) govern the CPA’s association with unaudited financial statements of nonpublic (private) companies, but not public companies.  a. True  b. False |
| 96.  medium  b | CPAs can issue a *WebTrust* opinion only on all five *Trust Services* principles.  a. True  b. False |
| 97.  medium  a | When performing a review (SSARS review) of financial statements, the accountant is required to obtain a letter of representation from management.  a. True  b. False |
| 98.  medium  b | The use of negative assurance is appropriate in audit reports.  a. True  b. False |
| 99.  medium  b | The use of positive assurance is appropriate in review reports.  a. True  b. False |
| 100.  medium  a | When performing compilation services, the accountant is not required to obtain an understanding of the client’s internal control.  a. True  b. False |
| 101.  medium  a | A CPA firm can issue a compilation report even if it is **not** independent with respect to the client.  a. True  b. False |
| 102. (Public)  medium  a | When performing a review of interim information for a public company, the accountant ordinarily does not perform tests of the accounting records, independent confirmations, or physical examinations.  a. True  b. False |
| 103.  medium  a | When issuing a debt compliance letter, the auditor’s opinion should be in the form of a negative assurance.  a. True  b. False |
| 104.  medium  b | Of the three types of attestation engagements, examination engagements provide a higher level of assurance than agreed-upon procedures engagements but less than review engagements.  a. True  b. False |

|  |  |
| --- | --- |
| 105.  medium  a | Examination attestation engagements result in a conclusion that is in a positive form, whereas review attestation engagements result in a conclusion in the form of a negative assurance.  a. True  b. False |
| 106.  medium  a | Current professional standards prohibit accountants from performing engagements to review forecasts or projections.  a. True  b. False |
| 107.  medium  a | The accountant’s report on the examination of prospective financial statements should include a caveat that the prospective results may not be achieved.  a. True  b. False |
| 108.  challenging  a | Auditors should provide debt compliance letters only for clients for whom the auditor has done an audit of the overall financial statements.  a. True  b. False |