***Auditing & Assurance Services: A Systematic Approach, 11e* (Messier)**

**Chapter 2 The Financial Statement Auditing Environment**

1) A series of business and related auditing failures led to the passage of the Sarbanes-Oxley Act (2002).

2) The primary audit context with which an auditor is concerned is the auditee's industry or business.

3) The audit committee generally includes senior executives of the organization.

4) A financial statement audit is generally organized based on the five basic business processes or cycles.

5) One of the five basic business processes is the warehousing cycle.

6) The ASB's auditing standards contain a preface that includes *Principles Underlying an Audit Conducted in Accordance with GAAS*.

7) PCAOB auditing standards must be followed on all financial statement audits performed in the U.S.

8) A financial statement audit must be conducted based on GAAP.

9) Generally, the financial statements of U.S. companies must be prepared based on GAAP.

10) PCAOB auditing standards must be followed on all audits of public companies' financial statements.

11) The Audit Committee consists of:

A) members of management.

B) a subcommittee of the AICPA who establish the SAS.

C) members of the Board of Directors.

D) appointed government overseers.

12) What organization is responsible for setting auditing standards for audits of publicly-traded companies in the U.S.?

A) AICPA.

B) FASB.

C) GASB.

D) PCAOB.

13) The Public Company Accounting Oversight Board's role is to:

A) conduct the final review of auditors' work before the auditor's opinion is issued.

B) oversee the auditors of public companies in order to protect the interests of investors.

C) conduct audits of governmental entities.

D) sanction auditors who fail to follow GAAS.

14) The authoritative body designed to promulgate standards concerning a CPA's association with audited financial statements of an entity that is required to file financial statements with the SEC is the:

A) financial accounting standards board.

B) general accounting office.

C) public company accounting oversight board.

D) auditing standards board.

15) The auditor must be independent of the auditee unless:

A) the lack of independence does not influence his or her professional judgment.

B) both parties agree that the independence issue is not a problem.

C) the lack of independence is insignificant.

D) none of the above—the auditor cannot lack independence.

16) Which principle of the *Principles Underlying an Audit Conducted in Accordance with GAAS* describes where auditors are required to plan the work and properly supervise any assistants?

A) Purpose of an Audit and Premise upon which an Audit is Conducted.

B) Performance.

C) Reporting.

D) Responsibilities.

17) Which of the following best describes the general character of the three principles that are listed in the Performance section of the *Principles Underlying an Audit Conducted in Accordance with GAAS*?

A) The purpose and value of a financial statement audit and lays out the responsibilities of management for an effective audit to be possible.

B) The fundamental responsibilities and characteristics of an auditor.

C) Auditors' responsibilities in performing an effective audit.

D) Auditors provide a written report that expresses their opinion about the financial statements.

18) The Responsibilities section of the *Principles Underlying an Audit Conducted in Accordance with GAAS* states that auditors are responsible for having appropriate competence and:

A) independence with respect to the financial statements and supplementary disclosures.

B) exercising professional care as judged by peer reviewers.

C) capabilities to perform the audit.

D) objectivity as an auditor as verified by proper supervision.

19) The Reporting section of the *Principles Underlying an Audit Conducted in Accordance with GAAS* requires that the report, "states whether the financial statements are presented fairly, in all material respects, in accordance with the applicable financial reporting framework." This passage requires:

A) a statement of fact by the auditor.

B) an opinion by the auditor.

C) an implied measure of fairness.

D) an objective measure of compliance.

20) Because of the risk of material misstatement, an audit of financial statements in accordance with generally accepted auditing standards should be planned and performed with an attitude of:

A) objective cynicism.

B) independent differentialism.

C) professional skepticism.

D) impartial conservatism.

21) The accuracy of information included in footnotes accompanying the audited financial statements issued by a company whose shares are traded on a stock exchange is the primary responsibility of:

A) the stock exchange officials.

B) the independent auditor.

C) the company's management.

D) the securities and exchange commission.

22) The primary responsibility for the adequacy of disclosures in the financial statements of a publicly held company rests with the:

A) partner assigned to the audit engagement.

B) management of the company.

C) auditor in charge of the fieldwork.

D) securities and exchange commission.

23) The largest public accounting firms typically are structured as:

A) subchapter S corporations.

B) professional corporations.

C) limited liability partnerships.

D) limited liability corporations.

24) Typically, an external auditor first gets supervisory experience at what level of authority?

A) Associate.

B) Senior.

C) Manager.

D) Partner.

25) An "in-charge" auditor typically holds the rank of:

A) associate.

B) senior.

C) manager.

D) partner.

26) Which of the following best describes the concept of risk assessment on which auditors can provide independent assurance?

A) The risk that financial statements are misstated because of fraud.

B) The risk that financial statements are misstated because of error or fraud.

C) Whether management has systems in place to evaluate and effectively manage the entity's business risks.

D) Developing client acceptance and continuance practices that minimize the likelihood of lawsuits against the auditor.

27) Forensic audits include all of the following except:

A) criminal investigations.

B) manufacturers' assertions about product quality.

C) employee fraud.

D) management fraud.

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

A) determine whether the financial statements present fairly 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.

29) Governmental auditing often extends beyond examinations leading to the expression of an opinion on the fairness of financial presentation and includes audits of efficiency, effectiveness, and:

A) monetary stimulus.

B) evaluation.

C) accuracy.

D) compliance.

30) External auditors are referred to as "external" because:

A) they report to users outside of the audited entity.

B) they are paid by parties outside of the audited entity.

C) they are not employees of the entity being audited.

D) their offices are not at the entity's place of business.

31) Which is NOT an attribute of an external auditor?

A) Independence.

B) Auditee advocacy.

C) Objectivity.

D) Concern for the public interest.

32) What is the general character of the work conducted in performing a forensic audit for a company?

A) Providing assurance that the financial statements are not materially misstated.

B) Detecting or deterring fraudulent activity.

C) Offering an opinion on the reliability of the specific assertions made by management.

D) Identifying the causes of an entity's financial difficulties.

33) Which of the following is NOT a requirement of the Sarbanes-Oxley Act?

A) Audit firms cannot provide most types of nonaudit services to their public company auditees.

B) Audit firms are required to rotate audit partners off audit engagements every five years for public company audits.

C) Firms that audit public companies are subject to inspection by the PCAOB.

D) A certain number of hours, which is based on the size of the company being audited, must be spent on each audit engagement.

34) A CPA is most likely to refer to one or more of the items listed in the Responsibilities section of the *Principles Underlying an Audit Conducted in Accordance with GAAS* in determining:

A) the nature of the CPA's report qualification.

B) the scope of the CPA's auditing procedures.

C) requirements for the review of the entity and its environment.

D) whether the CPA should undertake an audit engagement.

35) Who bears ultimate responsibility for the financial statements?

A) Management of the organization, equally with the external auditor that audits the statements.

B) Management and the shareholders of the organization.

C) The external auditor that audits the statements.

D) Management of the organization.

36) The Responsibilities section of the *Principles Underlying an Audit Conducted in Accordance with GAAS* is concerned with:

A) proper planning and supervision, appropriate materiality levels, and sufficient appropriate audit evidence.

B) an audit opinion in accordance with the auditor's findings, whether the financials are presented fairly, and whether the financial are in accordance with the applicable financial reporting framework.

C) whether the auditor has unrestricted access to those within the entity from whom the auditor needs to obtain audit evidence.

D) complying with ethical requirement, appropriate competence and maintaining professional skepticism.

37) The Responsibilities section of *Principles Underlying an Audit Conducted in Accordance with GAAS* recognizes that regardless of how capable an individual may be in other fields, the individual cannot meet the requirements of the auditing standards without the proper:

A) business and finance courses.

B) quality control and peer review.

C) education and experience in auditing.

D) supervision and review skills.

38) The main difference between SAS and AU is:

A) they are the same except that SAS are organized chronologically and the AU are organized by topical area.

B) SAS are issued by the ASB and AU are issued by the PCAOB.

C) SAS are issued by the PCAOB and AU are issued by the ASB.

D) SAS define minimum standards of performance for auditors while AU define financial accounting principles that must be followed according to GAAP.

39) The AICPA's Statements on Auditing Standards can be described as:

A) providing very specific guidance about the specific activities an auditor must perform on each engagement.

B) similar to financial accounting standards in that they are developed by the government.

C) tend to be general in nature and require a great deal of professional judgment.

D) providing assurance that an auditor will not issue an incorrect opinion.

40) Due professional care requires auditors to:

A) obtain independent, third party (non-auditee) documentation as evidence for all information presented in the financial statements.

B) exercise professional skepticism during the audit.

C) disregard any evidence generated by the auditee during the audit.

D) find every error contained in the financial statements prepared by management.

41) The objectives of the Reporting section of *Principles Underlying an Audit Conducted in Accordance with GAAS* are to provide assurance and include all of the following except for:

A) an opinion statement of whether the financial statements present fairly.

B) an opinion statement of whether the financials are free of material misstatements.

C) an opinion statement of whether the financials are in accordance with an applicable financial reporting framework.

D) an opinion statement of whether the financial statements between periods are not materially affected by changes in accounting principles that are not disclosed.

42) An internal auditor is likely to be more concerned with \_\_\_\_\_\_\_\_ than the external auditor.

A) internal administrative procedures

B) cost accounting procedures

C) the efficiency of operations

D) internal control

43) Which of the following is NOT included in the broad category of assurance services?

A) Operational audit.

B) Reporting on internal control.

C) Accounting or review services.

D) Evaluation of the auditee's risk management framework.

44) Which of the following is NOT explicitly a part of the IIA's definition of internal auditing?

A) Internal auditing is an objective assurance activity.

B) Internal auditing is a consulting activity.

C) Internal auditing should help an organization accomplish its objectives.

D) Internal auditors should help external auditors complete the annual financial statement audit.

45) Which of the following statements regarding the PCAOB is incorrect?

A) It is a public-sector, nonprofit corporation.

B) It is overseen by the SEC.

C) It sets standards for public company audits.

D) It has delegated all of its standard-setting authority to the AICPA.

46) Due professional care requires:

A) auditors to maintain an attitude that includes a questioning mind and a critical assessment of audit evidence.

B) the examination of all available corroborating evidence.

C) the exercise of error-free judgment.

D) a study and review of internal controls that includes tests of controls.

47) Which of the following best describes the role of corporate governance?

A) Management decides which accounting principles are the most appropriate.

B) Shareholders vote to decide who should be members of the board of directors.

C) Holding the management team accountable to shareholders and other constituents for the utilization of the entity's resources.

D) Management often is compensated based on the company's profitability.

48) The Performance section of *Principles Underlying an Audit Conducted in Accordance with GAAS* states that the auditor is unable to obtain absolute assurance that the financials are free of material misstatements because of inherent limitations which arise from all of the following except:

A) the presentation of the financial statements based on GAAS.

B) the nature of financial reporting.

C) the nature of audit procedures.

D) the need for the audit to be conducted within a reasonable period of time and so as to achieve a balance between benefit and cost.

49) Which of the following best describes what is meant by generally accepted auditing standards?

A) Audit assertions generally determined on audit engagements.

B) Acts to be performed by the auditor.

C) Standards of quality for the auditor's performance.

D) Procedures to be used to gather evidence to support financial statements.

50) The 'Purpose of an Audit and Premise upon which an Audit is Conducted'section of *Principles Underlying an Audit Conducted in Accordance with GAAS* states that management is responsible for all the following except for:

A) the preparation and fair presentation of the financial statement in accordance with the applicable financial reporting framework.

B) the design, implementation, and maintenance of internal control.

C) providing financial statement users with an opinion on whether the financial statements present fairly.

D) ensuring that the financial statements are free from material misstatement, whether due to error or fraud.

51) The Performance section of *Principles Underlying an Audit Conducted in Accordance with GAAS* states that for auditors to obtain reasonable assurance, they need to do all of the following except:

A) make sure all audit team members have adequate training.

B) obtain sufficient appropriate audit evidence.

C) identify and assess risks of material misstatement.

D) determine and apply appropriate materiality levels.

52) The Reporting section of *Principles Underlying an Audit Conducted in Accordance with GAAS* requires the auditor's report to contain either an expression of opinion regarding the financial statements taken as a whole or an assertion to the effect that an opinion cannot be expressed. The objective of this requirement is to prevent:

A) an auditor from reporting on one basic financial statement and not the others.

B) an auditor from expressing different opinions on each of the basic financial statements.

C) management from reducing its final responsibility for the basic financial statements.

D) misinterpretations regarding the degree of responsibility the auditor is assuming.

53) The Performance section of the "Principles Underlying an Audit" is concerned with:

A) proper planning and supervision, appropriate materiality levels, and sufficient appropriate audit evidence.

B) an audit opinion in accordance with the auditor's findings, whether the financials are presented fairly, and whether the financial are in accordance with the applicable financial reporting framework.

C) whether the auditor has unrestricted access to those within the entity from whom the auditor needs to obtain audit evidence.

D) complying with ethical requirement, appropriate competence and maintaining professional skepticism.

54) The Reporting section of the "Principles Underlying an Audit" is concerned with:

A) proper planning and supervision, appropriate materiality levels, and sufficient appropriate audit evidence.

B) the auditor expressing an audit opinion in accordance with the auditor's findings, whether the financials are presented fairly, and whether the financial are in accordance with the applicable financial reporting framework.

C) whether the auditor has unrestricted access to those within the entity from whom the auditor needs to obtain audit evidence.

D) complying with ethical requirements, appropriate competence and maintaining professional skepticism.

55) The IAASB and the ASB have collaborated on the principles underlying an audit conducted in accordance with generally accepted auditing standards. These principles are grouped into four categories. What are the four categories?

56) The principles underlying an audit conducted in accordance with generally accepted auditing standards are grouped into four categories. The second category is that of "personal responsibility of the auditor." Generally explain what is intended by this principle.

57) You are the owner of a small grocery store, Corner Marketplace. Explain the five process categories and how they apply to your business.

58) Define corporate governance, the board of directors, and the audit committee and explain how they relate to each other.

59) Describe the organizations involved in standard setting for auditors in the United States and what their respective roles are in setting current auditing standards for companies in the United States.

60) What are the four things required of an auditor to obtain reasonable assurance that are outlined in the Performance section of the *Principles Underlying an Audit Conducted in Accordance with GAAS*?

61) Jane Goodperson performed an audit on the Quagmire Corporation and issued an unqualified opinion. Jane performed the audit with due professional care and in accordance with generally accepted auditing standards. Two months after the report is issued, Jane discovers on the news that the CEO of Quagmire, Johnny Best, had been stealing small amounts of inventory. The amount, however, is immaterial compared to the overall inventory of the corporation. Jane soon receives a call from Quagmire's CFO, Mark Beastly. Mark wants Jane to refund her audit fees. Mark thinks Jane did not properly perform the audit, as she did not discover this fraud. Further, he feels that now Quagmire's financial statements are not fairly stated because of Jane. How should Jane respond to this claim?

62) Mike has just graduated from State University with a bachelor's degree in accounting. He would like to pursue a career in auditing. What options does Mike have? Describe three auditing career options, including a description of the organization Mike would work for.

63) With respect to an entity's financial statements, describe both the responsibility of management and that of the auditor.

64) What auditing standards are used to conduct an audit for a privately-held corporation? What auditing standards are used to conduct an audit for a publicly-traded corporation? What organization is responsible for setting each of these sets of standards?

65) There are several types of audit services that are provided by auditors. Identify and define three of these types of audits.