AICPA Released Questions from the 2021 Uniform CPA Exam

- Released April 2021 -

AUDITING & ATTESTATION

2021 AICPA Released Questions for AUD

The Key gives the correct letter answer for each question.

Key: A

The numbering system indicates the AICPA Blueprint Representative Task and Skill Level for each question.

AUD.CSO.20190701: AUD.001.001.001

AUD.SSO.20190701: Remembering and Understanding:1

MULTIPLE CHOICE - MODERATE

Each of the following is a required characteristic of a review engagement of management's discussion and analysis (MD&A), **except:**

A. It consists principally of applying tests of details through inspection, observation, and confirmation.

B. The practitioner applies analytical procedures.

C. An objective is to report if any information came to the practitioner's attention that the MD&A is **not** reasonably presented.

D. The practitioner makes inquiries of individuals responsible for financial matters.

Publicly held entities are required to provide a set of disclosures referred to as **Management Discussion and Analysis (MD&A)** in accordance with certain rules prescribed by the SEC. A CPA may be engaged to perform either an examination or a review.

A review may be performed for an annual period, an interim period, or a combination of an annual and an interim period. A review report will indicate that nothing came to the accountant's attention (ie, primarily negative assurance) to indicate that:

- A review includes primarily **applying analytical** procedures to management's financial data and **making inquiries** of company management (tests of details are not performed in a review).
- All required elements were not included.
- The historical financial information was not derived from the F/S.
- The information, determinations, estimates, and assumptions did not provide a reasonable basis for the disclosures.

Item ID: 16323

Key: A

AUD.CSO.20190701: AUD.001.001.003

AUD.SSO.20190701: Remembering and Understanding:1

Banister, a CPA, is approached by Wagner, a client. Wagner requests that Banister return the records provided to Banister by Wagner during an audit. Wagner still owes Banister the fees associated with the audit. According to the AICPA Code of Professional Conduct, what should Banister do?

A. Banister should return the records to Wagner.

B. Banister should return the records to Wagner only after the fee has been paid.

C. Banister should **not** return the records to Wagner because the records now belong to Banister.

D. Banister should **not** return the records to Wagner without a court order.

By behaving unethically, a CPA could reduce trust in the CPA credential. For this reason, the AICPA Code of Professional Conduct prohibits CPAs from doing anything that may harm the reputation of the profession.

Acts discreditable to the profession include **failure to return client records**. Punishments can include suspension or revocation of the CPA's license by state boards. It is important to make the distinction between client records and the CPA's work products.

A CPA is obligated to return client records on demand because they are the property of the client. However, documents prepared by the CPA (eg, workpapers) generally remain the property of the CPA.

Item ID: 11685
Key: A
AUD.CSO.20190701: AUD.001.002.001
AUD.SSO.20190701: Application:2

An accountant's working papers for an engagement to review the financial statements of a nonpublic entity would be **least** likely to include which of the following forms of documentation?

A. Study and evaluation of internal control.

B. Explanation of analytical procedures performed.

C. A copy of the engagement letter.

D. Copies of representation letters from client management.

In an engagement to **review** financial statements (F/S), an accountant provides **limited assurance** that no material modifications are necessary for the F/S to conform to the reporting framework (eg, GAAP).

Because reviews provide only limited assurance, the procedures performed are likewise limited. They primarily involve analytical procedures and inquiries of client personnel, principally management.

Analytical procedures involve developing an expectation about what financial amounts should be (eg, based on prior-year results) and comparing that expectation with the actual recorded financial results. A review does not involve study and evaluation internal control.

The accountant’s **documentation for a review engagement** should include (list is not all-inclusive):

- The engagement letter (or a copy thereof).
- Explanation of analytical procedures performed.
- Communication with management regarding fraud or noncompliance with applicable laws and regulations.
- Management representation letter (or copy thereof).
- Reviewed F/S
- Review report

Item ID: 11197
Key: A
AUD.CSO.20190701: AUD.001.004.000
AUD.SSO.20190701: Remembering and Understanding:1

If differences of opinion arise between the engagement partner and the engagement quality control reviewer, then the engagement partner should

A. Follow the firm's policies and procedures for resolving differences of opinion.

B. Issue a disclaimer of opinion and report the issue to the entity's audit committee.

C. Discuss the differences of opinion with the entity's management and issue a modified auditor's report.

D. Withdraw from the engagement when permissible under law or regulation.

A CPA firm is required to establish a **system of quality control.** These standards are explicitly limited in their application to a firm's accounting and auditing practice. The standards are designed to provide it with reasonable assurance that:

- The firm and its personnel comply with professional standards and applicable regulatory and legal requirements.
- The firm or engagement partners issue reports that are appropriate in the circumstances.

A system of quality control consists of policies designed to achieve these objectives and the procedures necessary to implement and monitor compliance with those policies. the quality control review is strictly an internal process; it does not involve the client or the audit report for that particular engagement.

If differences of opinion arise between the engagement partner and the engagement quality control reviewer, then the engagement partner should follow the firm's policies and procedures for resolving differences of opinion.

Item ID: 17585
Key: A
AUD.CSO.20190701: AUD.001.007.000
AUD.SSO.20190701: Application:2

An accountant is reviewing the financial statements of a nonpublic entity in accordance with *Statements on Standards for Accounting and Review Services* (SSARS). The accountant most likely would perform which of the following procedures?

A. Obtain an understanding of the internal control structure.

B. Make inquiries about subsequent events.

C. Send bank account confirmations.

D. Perform limited tests of controls.

In an engagement to **review** financial statements (F/S), an accountant provides **limited assurance** that no material modifications are necessary for the F/S to conform to the reporting framework (eg, GAAP).

Because reviews provide only limited assurance, the procedures performed are likewise limited. They primarily involve analytical procedures and inquiries of client personnel, principally management. Reviews do not include reviewing or testing internal controls nor do they usually include test of details like sending confirmations.

Making inquiries of management and of others with knowledge of accounting matters is one means by which the accountant obtains review evidence. Certain inquiries should be made in every review engagement, including inquiries regarding **subsequent events**.

If the accountant becomes aware of subsequent events that may require reporting or disclosure in the F/S, the accountant will evaluate how the event is reflected in the F/S.

- If the subsequent event is appropriately accounted for or disclosed, as required, the accountant may decide to include an emphasis-of-matter paragraph in the report to draw attention to the matter.
- If the subsequent event is not appropriately accounted for or disclosed, the accountant will treat it as a departure from the AFRF and modify the report or take other action, as appropriate.

Item ID: 11469
Key: B
AUD.CSO.20190701: AUD.002.001.002
AUD.SSO.20190701: Application:2

Which of the following factors would an auditor most likely consider in evaluating the control environment for an audit client?

A. Monthly bank reconciliations with supervisor sign-offs.

B. The ethical values demonstrated by management.

C. Organizational structure used for tax purposes.

D. The number of employees in each department.

The first component of the COSO framework is the **control environment**, also referred to as the **tone at the top**. The control environment sets the tone of an organization, influencing the control consciousness of its people. It is the foundation for all other components of I/C, providing discipline and structure.

The auditor is responsible for determining if the control environment, influenced by management with the oversight of those charged with governance, has established an honest culture, promoting ethical behavior.

There are five principles related to the control environment. They indicate that management and those charge with governance:

1. **Demonstrate a commitment to integrity and ethical values**
2. Exercise their oversight responsibility
3. Establish structure, authority, and responsibility
4. Demonstrate a commitment to competence
5. Enforce accountability

Item ID: 14209
Key: B
AUD.CSO.20190701: AUD.002.003.001
AUD.SSO.20190701: Application:2

Which of the following factors represents an inherent limitation of internal control?

A. Absence of segregation of duties.

B. Failure to perform required tasks.

C. Mistakes resulting from human error.

D. Inadequate provisions to safeguard assets.

A system of I/C can be designed to provide only *reasonable assurance* of achieving an entity's objectives. That is, even with an effective system of I/C, the following **inherent limitations** (COP) may result in failures (ie, fraud and error):

- Collusion – Control activities that depend on segregation of duties will not be effective if those engaged in the segregated functions conspire with one another.
- Override by management – Since management designs and implements the system of I/C, it is able to override it.
- Poor human judgment and errors – If control procedures are erroneously applied, they will not be effective. I/C cannot be expected to prevent mistakes in human judgment.

The remaining answer choices can have a negative impact of internal controls, but they are not inherent. In other words, an absence or disregard of a control can be corrected. Inherent limitations remain, despite any action taken to mitigate their risk.

Item ID: 11007
Key: C
AUD.CSO.20190701: AUD.002.003.005
AUD.SSO.20190701: Remembering and Understanding:1

When conducting a review engagement of a nonissuer, each of the following is considered an analytical procedure, **except** a comparison of the current-year's financial information to

A. Expectations developed by the accountant.

B. Financial statements of a comparable prior period.

C. Supporting documentation.

D. Industry benchmarks.

The objective of a review of financial statements (F/S) is to obtain **limited assurance** whether there are any material modifications that should be made to the F/S. This assurance is obtained primarily through the **performance of inquiries** and **analytical procedures**.

Analytical procedures consist of the performance of three essential steps:

1. The accountant uses their understanding of the industry, client knowledge, and general knowledge about business, accounting, and the economy to **develop expectations**.
2. The accountant will compare the client's data to expectations to determine if variances are within a reasonable range.
3. Any significant differences are investigated by inquiring of management and performing other review procedures, if necessary. Note that management's responses are **not required to be corroborated** with supporting documentation.

Specific analytical procedures that the accountant should perform include:

- Comparing current period financial statement data to prior period data.
- Considering plausible relationships among financial and nonfinancial data.
- Comparing amounts reported in the financial statements to the accountant's expectations.
- Comparing disaggregated revenue data (eg, revenue reported by month).

Item ID: 16925
Key: C
AUD.CSO.20190701: AUD.002.005.003
AUD.SSO.20190701: Application:2

As part of risk assessment procedures for an audit of a nonissuer, an auditor would most likely perform which of the following procedures concerning related-party transactions?

A. Evaluate the entity's procedures for identifying related-party transactions.

B. Confirm related-party transaction amounts and terms with the other party.

C. Perform a direct test of related-party account balances.

D. Examine receiving and shipping records between the client and its affiliates.

When a company has engaged in significant related party transactions, the auditor's primary concern is to ensure the **users of the F/S are made aware** of them through proper disclosure and presentation.

Inquiries of management regarding related parties, made as part of the auditor’s risk assessment procedures, will include:

- The identities of the entity’s related parties, including changes from prior periods.
- The nature of the relationships between the entity and the related parties.
- Whether the entity entered into any transactions with the related parties during the period and, if so, the type and purpose of the transactions.

The auditor will also perform additional risk assessment procedures to **obtain an understanding of management’s controls** for:

- **Identifying**, accounting for, and disclosing related-party relationships and transactions.
- Authorizing and approving significant transactions and arrangements with related parties.
- Authorizing and approving significant transactions and arrangements outside the normal course of business.

Item ID: 24521
Key: A
AUD.CSO.20190701: AUD.002.008.003
AUD.SSO.20190701: Application:2

Which of the following applications of sampling to test controls is most appropriate?

A. Testing a sample of customer orders for evidence of credit approval.

B. Testing a sample of controls to determine segregation of duties between inventory control and sales processing duties.

C. Testing a sample of accounts receivable confirmations.

D. Testing a sample of the budget center directors' allocation of annual budget to sales units.

AU-C 530, Audit Sampling, refers to the examination of **less than 100% of a population** and using the results as a basis for drawing a general conclusion on the entire population. Sampling is used both in the tests of controls and in substantive testing:

1. During the internal control phase of the audit, the auditor will **perform tests of controls** on a sample basis to determine the operating effectiveness of controls they plan to rely on.

2. During the substantive testing phase of the audit, the auditor will **perform tests of details** of transactions, accounts, and disclosures on a sample basis to obtain sufficient appropriate audit evidence to support management assertions.

Sampling is **not practical** for all parts of the audit. The primary risk in sampling is that the auditor may draw a conclusion from the sample that is different from the conclusion that would have drawn if the entire population was examined.

In gaining an understanding of the internal control structure and documenting the understanding, the auditor cannot simply look at a part of the structure and use that as a basis for claiming understanding of the entirety. During substantive testing, the application of analytical procedures to some accounts cannot be considered evidence applicable to all the accounts.

An example of where sampling to test controls would be appropriate is testing a sample of customer orders for evidence of credit approval.

Item ID: 12737
Key: A
AUD.CSO.20190701: AUD.003.002.000
AUD.SSO.20190701: Application:2

When evaluating the impact of potential litigation, an auditor of a nonissuer should obtain audit evidence about each of the following, **except**

A. The period in which the underlying cause for legal action occurred.

B. The probability of an unfavorable outcome.

C. The probability that the matter will require a trial in court.

D. The amount or range of potential loss.

Contingencies represent gains or losses that may or may not occur in the future as a result of an event that has already occurred or an existing condition. Contingencies may result from potential or asserted litigation.

Contingent gains may not be accrued and are not required to be disclosed. The auditor is only required to determine if those disclosures regarding gain contingencies included in the F/S are appropriate.

Contingent liabilities are required to be accrued and disclosed when they are probable and estimable; disclosed without accrual if either they are probable but not subject to reasonable estimation or if they are reasonably possible; and neither accrued nor disclosed if remote.

Ordinarily, management's information regarding the outcome of potential litigation would include:

(1) the nature of the litigation.

(2) the progress of the case to date.

(3) how management is responding or intends to respond to the litigation.

(4) an evaluation of the likelihood of an unfavorable outcome.

(5) an estimate of the amount or range of potential loss.

The probability that the matter will require a trial in court is not a concern.

Item ID: 18573
Key: C
AUD.CSO.20190701: AUD.003.004.004
AUD.SSO.20190701: Application:2

If a subsequent event occurs after the report date but prior to the release date of an audit report, resulting in management's revision of the financial statements of a nonissuer, then the auditor may do any of the following, **except**

A. Maintain the original date of the report and state that the opinion is limited to the financial statements as they existed prior to the subsequent event.

B. Perform audit procedures necessary to obtain assurance about the revised financial statements.

C. Include an additional date in the audit report that is limited to the revision to the financial statements.

D. Revise the date of the audit report to reflect the necessity of additional audit procedures.

Subsequent events are events occurring during the time interval between the B/S date but before the report is issued. Such events may have an impact in one of two ways:

Type 1 – Events that **provide evidence of conditions** existing at the B/S date that should be recognized and require adjustment to the F/S.

Type 2 – Events/conditions that did not exist at the B/S date, but still represent important information. These events are not recognized but should be disclosed to assist users of the F/S.

Subsequent events must be evaluated by nonissuers through either the date of issuance of the F/S or the date that the F/S are available to be issued. If management's response to a subsequent event is to appropriately revise the F/S, the auditor can:

- Perform audit procedures necessary to obtain assurance about the revised financial statements.
- Include an additional date in the audit report that is limited to the revision to the financial statements (ie, dual-date the report).
- Revise the date of the audit report to reflect the necessity of additional audit procedures.

The auditor cannot maintain the original date of the report and state that the opinion is limited to the financial statements as they existed prior to the subsequent event.

Item ID: 18401
Key: A
AUD.CSO.20190701: AUD.003.007.000
AUD.SSO.20190701: Application:2

A client holds a debt security that is actively traded in the market. Which of the following indicators would be the preferable guide to the security's fair market value?

A. Published price quotations in the market.

B. The price at which the debt security was purchased.

C. The cash flow model using discounted future cash flows.

D. Matrix pricing, in which published price quotations of similar debt securities are used to compute the fair market value.

When auditing investments in securities, there are four objectives to be addressed:

- Rights & obligations – Does the entity own the investments?
- Allocation & valuation – Are the investments reported at appropriate amounts?
- Completeness – Are all the investments reported?
- Existence – Do all the investments actually exist?

To obtain evidence about **valuation**, the auditor will determine if there are appropriate policies and procedures in place for obtaining **fair value information**. Fair value is the price that would be received when selling an asset in an orderly transaction.

There are **three levels of inputs** used as indicators for fair value determination:

- Level I, the **most reliable**, involves the use of observable data from actual market transactions (eg, **published price quotations**)
- Level II also involves the use of observable data from actual market transactions but either:
  - o The transactions did not occur in an *active* market
  - o The transactions relate to similar, but not identical, assets or liabilities
- Level III involves the use of unobservable data and are largely based on management's judgment.

Historical cost is not relevant for determining fair value. The cash flow model using discounted future cash flows is a *valuation technique*, but is not, in and of itself, an appropriate indicator. Matrix pricing, in which published price quotations of similar debt securities are used, would be an adequate Level 2 input, but a Level 1 input is superior.

Item ID: 20223
Key: A
AUD.CSO.20190701: AUD.003.004.002
AUD.SSO.20190701: Remembering and Understanding:1

Which of the following most likely would be considered a mitigating condition concerning an entity's ability to continue as a going concern?

A. Plans to increase ownership equity.

B. Recent strong showing of the stock market.

C. Positive comments about the company from industry analysts.

D. A decreasing unemployment rate in the entity's industry.

During an audit, events or conditions may have been identified which indicate a going concern problem. In that case, the auditor is required to obtain sufficient appropriate audit evidence as to whether they, when considered in the aggregate, raise a *substantial doubt* about the entity's ability to continue as a going concern for a reasonable period of time, as well as any mitigating factors.

When considering a going concern risk, the primary issue~~s~~ to be considered is **cash flow**, since a company is most likely to fail if it is unable to pay its debts as they come due. Factors that may produce substantial doubt as to the going concern status of the client include:

- Several years of operating losses.
- Negative working capital.
- Defaults or restructuring of debts.
- Losses of key customers.
- Denial or losses of licenses or patents.

There are, however, certain **mitigating factors** that may reduce the risk of going out of business by improving cash flow, such as plans to:

1. **Increase ownership** equity through stock issuances for cash.
2. Dispose of marketable assets that are not needed in the operations of the business.
3. Delay or reduce optional expenditures, such as research and development.

Recent strong showing of the stock market, positive comments from industry analysts and a decreasing unemployment rate in the entity's industry do not provide evidence of the strength of the entity's cash flow or ability to stay in business.

Item ID: 14021
Key: A
AUD.CSO.20190701: AUD.003.004.005
AUD.SSO.20190701: Remembering and Understanding:1

Whose signatures should be included in the management representation letter to the auditor?

A. President and chief financial officer.

B. Chairman of the audit committee and chief operating officer.

C. Corporate secretary and treasurer.

D. Chief information officer and chief operating officer.

The auditor is required to obtain a letter from the client's management reaffirming in writing some of the information that was provided to the auditor during the audit and confirming other matters (eg, that all appropriate information was made available to the auditor).

The letter of representations is:

- Dated as of the audit report date, which is the date on which the auditor has determined that sufficient appropriate audit evidence has been obtained, generally the final day of fieldwork.
- Required to cover all of the F/S and periods referred to in the audit report.

The letter should be signed by the president (ie, chief executive officer) and chief financial officer (CFO) of the client.

Item ID: 13699
Key: A
AUD.CSO.20190701: AUD.003.006.000
AUD.SSO.20190701: Remembering and Understanding:1

An accountant who is engaged to issue a compilation report on one or more specified elements, accounts, or items of a financial statement

A. Must adhere to the compilation performance requirements contained in the *Statements on Standards for Attestation Engagements*.

B. Should attest whether such compiled elements, accounts, or items of a financial statement are free of material errors.

C. Should **not** describe the basis on which the accounts are presented if that basis is other than generally accepted accounting principles.

D. Can issue the report for an entity of which the accountant is **not** independent.

In a compilation engagement, an accountant assists a client in presenting financial statements (F/S) or supplementary information. Compilations may also be performed on specified elements, accounts, or items of F/S (eg, provision for income taxes.)

Although a compilation requires the accountant to read the F/S or other compiled material to verify that there are no *obvious* material errors, it is not an attestation engagement, and it provides no assurance.

Unlike an audit or review, accountants **may issue** a **compilation report** even if they are **not independent** of the client. When doing so, they are required to **state** in the report that they are **not independent**.

If the F/S compiled use a basis of accounting other than GAAP, the compilation report should describe that basis.

Item ID: 15595
Key: D
AUD.CSO.20190701: AUD.004.003.002
AUD.SSO.20190701: Remembering and Understanding:1

Which of the following is a correct statement regarding reporting on reviewed financial statements for a nonissuer?

A. An accountant who is **not** independent is allowed to issue a review report as long as the accountant discloses the lack of independence in the review report.

B. The date of the accountant's review report should be the day the accountant discusses the draft report with management.

C. Reviewed financial statements must be prepared in accordance with generally accepted accounting principles.

D. An accountant is allowed to issue a review report on the balance sheet only and not on the other related financial statements as long as the scope of inquiry and analytical procedures were **not** restricted.

AR-C 90 indicates that the objective of a review of financial statements (F/S) is to obtain limited assurance as a basis for reporting whether there are any material modifications that should be made to the F/S to be in accordance with the applicable financial reporting framework (AFRF), primarily through the performance of inquiries and analytical procedures.

The accountant may review a single F/S, such as a balance sheet, provided the scope of the accountant's inquiry and analytical procedures is not restricted.

An accountant must be independent to perform a review. The date of the review report should be no earlier than the date on which the accountant completed sufficient procedures to obtain reasonable assurance for reporting whether any material modifications must be made to the report.

Reviewed financial statements do not need to be prepared in accordance with GAAP. The AFRF can be one adopted by management or governance that is acceptable in view of the nature of the entity.

Item ID: 17003
Key: D
AUD.CSO.20190701: AUD.004.003.003
AUD.SSO.20190701: Remembering and Understanding:1

Under which of the following circumstances would an auditor most likely issue either a qualified or a disclaimer of opinion?

A. The financial statements contain an immaterial departure from generally accepted accounting principles (GAAP).

B. The auditor performed alternate substantive procedures to provide adequate assurance due to missing documentation.

C. There is substantial doubt about the entity's ability to continue as a going concern.

D. The client's attorney refused to respond to the letter of audit inquiry.

The auditor is required to prepare and arrange for management to sign a letter of inquiry to the attorney to obtain corroborating evidence. The letter will identify those matters about which the auditor was informed by management, and request that the attorney corroborate information about the likelihood of losses and, where appropriate, estimates of the amount of losses.

If the attorney refuses to respond to the letter of inquiry, or if management refuses to give the auditor permission to communicate with the entity's external legal counsel, it is considered a scope limitation and may **require a qualified opinion or disclaimer of opinion**.

Immaterial departures for GAAP do not affect the audit report. Performing alternate substantive procedures to provide adequate assurance due to missing documentation is the appropriate response to this issue. It does not need to be disclosed in the report and does not affect the audit opinion.

In general, going concern matters are required to be adequately disclosed but do not impact the audit opinion. However, if the going concern doubt is extreme, a disclaimer may be warranted.

Item ID: 11151
Key: D
AUD.CSO.20190701: AUD.004.001.001
AUD.SSO.20190701: Remembering and Understanding:1

MULTIPLE CHOICE - HARD

Each of the following is normally performed while conducting a review of interim financial information, **except**

A. Comparing disaggregated revenue data.

B. Making inquiries of financial management.

C. Reading minutes of the meetings of the board of directors.

D. Obtaining litigation updates from external legal counsel.

Typically, the auditor of the annual F/S will perform a review of interim financial information. Like all reviews, this engagement consists principally of **inquiries** of company personnel and **analytical procedures** applied to financial data. A review results in the expression of **limited assurance (negative assurance)** by the accountant.

Some of the required procedures that an accountant must perform in an interim review engagement include:

- Comparing disaggregated revenue data (eg, comparing revenue by month for the current interim period with that of comparable prior periods).
- Obtaining evidence that the interim financial information agrees or reconciles with the accounting records.
- Reading minutes of the meetings of the board of directors.
- Inquiring of financial management about their knowledge of any fraud or suspected fraud.
- Reading the F/S and notes to ensure that they are free of material error and appropriate in form.

Auditors do not need to obtain litigation updates from external legal counsel for interim reviews.

Item ID: 21709
Key: D
AUD.CSO.20190701: AUD.001.001.003
AUD.SSO.20190701: Remembering and Understanding:1

According to the SEC, which of the following best describes a non-audit service that, when jointly provided with the audit of an issuer, would result in the accountant's loss of independence?

A. Preparing the client's tax returns based on information prepared by management.

B. Providing a comfort letter in regard to the client's meeting the debt covenant requirements.

C. Issuing a report on management's assessment of the client's internal controls.

D. Preparing the client's footnote disclosure of significant accounting policies.

If an accounting firm performs both audit and non-audit services for the same client, potential threats to the auditing firm's independence may arise. To prevent such threats, the **SEC prevents many non-audit services** from being performed for issuer audit clients.

Non-audit services prohibited for issuer audit clients include the following:

- Bookkeeping, including preparation of financial statements (F/S) or elements of F/S, such as **footnote disclosures**.
- Internal audit outsourcing.
- Information system design or implementation.
- Appraisal, valuation, or actuarial services.
- Human resource or other management functions.
- Investment banking, broker-dealer, or investment advisory services.
- Legal services unrelated to the audit.

Tax services are generally permitted for audit clients because they do not ordinarily create significant independence threats. Auditors routinely provide comfort letters to underwriters of audit clients' securities. Because issuers are required to have integrated audits, auditors not only can, but must report on management's assessment of internal control.

Item ID: 22905
Key: D
AUD.CSO.20190701: AUD.001.002.002
AUD.SSO.20190701: Application:2

In connection with an audit of a nonissuer, the auditor would ordinarily use an engagement letter to

A. Mutually agree upon contingent fees between the company and the auditor.

B. Assert that a properly planned audit will detect and identify all material misstatements.

C. Specify any arrangements concerning the involvement of the company's internal auditors on the audit.

D. Determine which of the company's financial statement notes will be compiled by the auditor during the audit.

Once an auditor has decided to accept an engagement, the auditor is required to send a written engagement letter (recommended) or a comparable written agreement to the client. In it, the auditor will confirm the scope and nature of the engagement and the responsibilities of the auditor and management. The engagement letter is signed by both the client and the auditor.

A statement is included that, due to the inherent limitations of an audit and I/C, material **misstatements may not be detected** (even though the audit is properly planned and performed in accordance with GAAS).

The company's financial statement notes cannot be compiled by the auditor as this would violate independence rules.

Other matters may be referred to in the engagement letter, such as:

- Matters related to the planning and performance of the engagement.
- The anticipation that management will provide written representations.
- Management’s agreement to inform the auditor of subsequent events and subsequently discovered facts relevant to the F/S.
- Fees and billing arrangements (**contingent fees are not permitted).**
- The involvement of other auditors and specialists.
- The **involvement of internal auditors** and other entity staff
- Arrangements to be made with the predecessor auditor (for an initial audit).
- The auditor’s obligations, if any, to provide audit documentation to other parties.

Item ID: 74281
Key: C
AUD.CSO.20190701: AUD.001.003.002
AUD.SSO.20190701: Application:2

Which of the following correctly identifies the deadline for the completion of audit documentation of a nonissuer?

A. Within 60 days after the report release date.

B. Within 45 days after the report release date.

C. Within 90 days after the last day of field work.

D. Within 45 days after the last day of field work.

AU-C 230 requires audit documentation (ie, working papers) to be sufficient to enable an experienced auditor, having no previous connection with the audit, to understand:

- The nature, timing, and extent of the audit procedures performed to comply with GAAS and applicable legal and regulatory requirements.
- The results of the audit procedures performed and the audit evidence obtained.
- Significant findings or issues arising during the audit, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions.

In addition, audit documentation should (list not all-inclusive):

- Indicate the engagement team members who performed and reviewed the work.
- Include a written audit program (or set of audit programs) for every audit.
- Be completed no later than **60 days following the report release date**.
- Be retained at least five years from the report release date.
- Document procedures performed, evidence examined, and conclusions reached.

Item ID: 24601
Key: A
AUD.CSO.20190701: AUD.001.004.000
AUD.SSO.20190701: Remembering and Understanding:1

An accountant has a work program that consists entirely of the following steps:

1. Obtain knowledge of the accounting principles and practices of the client's industry.
2. Obtain knowledge of the client.
3. Make inquiries of the client's management about accounting procedures, the consistent application of generally accepted accounting principles (GAAP) in the preparation of the financial statements, and actions taken at meetings of stockholders and the board of directors.
4. Perform analytical procedures.
5. Obtain a letter of representation from management.

Which of the following types of engagements is the CPA performing?

A. Attestation.

B. Audit.

C. Compilation.

D. Review.

The objective of a review of financial statements (F/S) is to provide limited assurance that there are no material modifications that should be made to the F/S to be in accordance with the applicable financial reporting framework (AFRF).

For a review engagement, the accountant should:

- Obtain an **understanding of the client's industry**, including accounting principles and practices generally used.
- Obtain an **understanding of the client, their business, and accounting policies and practices.**
- Design and perform **analytical procedures**, **make inquiries**, and perform other procedures, as appropriate.
- **Obtain written representations** from management in the form of a representation letter.

Certain inquiries should be made in every review engagement, including inquiries regarding:

- The preparation and fair presentation of the F/S in accordance with the AFRF, including any unusual or complex transactions or other circumstances that may impact the F/S.
- Significant transactions, especially those occurring near the end of the period.
- Results of analytical procedures requiring further clarification or support.
- Actions taken at meetings of the board, stockholders, or other relevant groups.

Although a review of financial statements is an *attest* engagement, it is not an *attestation* engagement. Attestation engagements are those covered by SSAE. A review of financial statements is covered by SSARS, not SSAE.

Because an audit provides a higher level of assurance than a review, it also involves understanding the client's internal controls and tests of details among other procedures not listed here.

A compilation engagement, unlike a review, offers no assurance. As such, a compilation does not require analytical procedures, inquiries designed to detect misstatements, or a management representation letter.

Item ID: 13705
Key: D
AUD.CSO.20190701: AUD.002.001.002
AUD.SSO.20190701: Application:2

Which of the following is usually considered a monitoring activity?

A. Segregating duties of employees.

B. Processing entity transactions.

C. Analyzing new information systems.

D. Using information from customer complaints.

The most commonly used framework to benchmark internal controls (I/C) in the U.S. *is Internal Control – Integrated Framework* developed by COSO. The framework consists of five components: the control environment, risk assessment, control activities, information and communication, and monitoring.

Monitoring activities are how management determines if I/C are being followed and if they are effective. Controls are monitored through some combination of ongoing activities, such as the supervision of employees and separate evaluations.

For example, a company may use information from customer complaints to help determine if there is a break-down in I/C. If a customer complains that their payment wasn't processed, it could be an indication of an error or fraud on the part of the accounts payable clerk.

Segregation of duties, controls over processing transactions, and analyzing new IT systems are all control activities.

Item ID: 13947
Key: D
AUD.CSO.20190701: AUD.002.003.001
AUD.SSO.20190701: Application:2

In an integrated audit of a nonissuer, each of the following identifies an inherent limitation to internal control, **except**

A. Breakdowns in internal control because of employee mistakes.

B. Collusion involving two or more employees.

C. Faulty decision making by employees.

D. An override of internal controls by a low-level employee.

A system of I/C can be designed to provide only *reasonable assurance* of achieving an entity's objectives. That is, even with an effective system of I/C, the following **inherent limitations** (COP) may result in failures (ie, fraud and error):

Collusion – Control activities that depend on segregation of duties will not be effective if those engaged in the segregated functions conspire with one another.

Override by management – Since management designs and implements the system of I/C, it is able to override it.

Poor human judgment and errors – If control procedures are erroneously applied, they will not be effective. I/C cannot be expected to prevent mistakes in human judgment.

An override of internal controls by a *low-level employee* is likely to be detected by management and is not an inherent limitation. In other words, additional controls *can be established* by management which prevent or detect an override of other controls by lower-level employees. But by that same logic, controls established by higher-level employees (ie, management) can be overridden without detection.

Item ID: 17179
Key: D
AUD.CSO.20190701: AUD.002.003.005
AUD.SSO.20190701: Remembering and Understanding:1

For which of the following assertions related to accounts receivable would an auditor's initial assessment of risk of material misstatement of a nonissuer be increased if the auditor discovers that client management does **not** regularly review the collectability of accounts receivable balances?

A. Valuation.

B. Existence.

C. Rights and obligations.

D. Completeness.

Management's assertions are **representations made by management** about the financial statements (F/S) being audited. Management makes assertions regarding the recognition, measurement, presentation, and disclosure of information in the F/S and related disclosures.

All procedures applied in an audit are directed toward the eventual goal of expressing an opinion on the F/S. The auditor should always keep in mind the management assertions that are represented in the F/S. These assertions can be summarized as follows:

Classes of Transactions & Events (CPA-CO)	Account Balances at Year-end (RACE)	Presentation & Disclosures (RACOUn)
***C**ompleteness*	***R**ights & Obligations*	***Ri**ghts & Obligations*
***P**eriod Cutoff*	***A**llocation & Valuation*	***A**ccuracy & Valuation*
***A**ccuracy*	***C**ompleteness*	***C**ompleteness*
***C**lassification*	***E**xistence*	***O**ccurrence*
***O**ccurrence*		***Un**derstandability & Classification*

Valuation is management's assertion that assets, liabilities, and equity interests are valued using a method in accordance with GAAP. If an auditor finds that the client does not regularly review the collectability of accounts receivable balances, the risk of material misstatement with respect to the valuation assertion will be increased.

Existence is management's assertion that all assets, liabilities, and equity interests listed on the balance sheet exist. Rights and obligations are management's assertions that it is the legal owner of all assets listed on the F/S, and that the liabilities represent legal obligations of the entity. Completeness is the assertion that ALL assets, liabilities, equity interests, transactions and events have been recorded and ALL appropriate disclosures have been included in the F/S.

Item ID: 17069
Key: A
AUD.CSO.20190701: AUD.002.005.002
AUD.SSO.20190701: Application:2

In response to an increased level of assessed risk of material misstatement, an auditor of a nonissuer would generally

A. Not make changes to the nature, timing, or extent of further audit procedures.

B. Increase the emphasis on professional skepticism when gathering and evaluating audit evidence with the audit team.

C. Perform more substantive audit procedures at an interim date instead of at period end.

D. Perform additional tests of controls at an interim date to eliminate the need for substantive tests at period end.

The purpose of obtaining an understanding of the entity and its environment is to identify and assess risks of material misstatement (RMM). This provides the basis for designing and implementing responses to those risks.

To address the RMM at the financial statement level, the auditor should revise the nature, timing, and/or extent of further audit procedures. Some of the auditor's responses to **reduce audit risk** to an acceptably low level may include:

- **Increasing professional skepticism**.
- Assigning more experienced audit staff with specialized skills or even using specialists.
- Increasing staff supervision.
- Incorporating more unpredictability into audit testing.
- Perform less test of controls and more substantive testing.
- Shift interim substantive testing to year-end substantive testing.

Item ID: 14839
Key: B
AUD.CSO.20190701: AUD.002.005.003
AUD.SSO.20190701: Application:2

Which of the following conditions necessitates a larger sample size?

A. A high level of detection risk.

B. A low frequency of misstatement.

C. A low level of tolerable misstatement.

D. A low assessed level of control risk.

Audit sampling refers to the examination of less than 100% of a population and using the results as a basis for drawing a general conclusion on the entire population. While audit data analytics (ADAs) can be used to test entire populations of data efficiently and effectively, there are still instances in which the use of sampling is essential.

There are two risks associated with attribute sampling. First, assessing RMM too high, which will result in an inefficient engagement. Second, assessing RMM too low, which will result in an ineffective engagement.

Factors affecting **sample size** in an attribute sample include:

- The **tolerable rate of error** has an **inverse relationship** to sample size. A low level of tolerable misstatement implies a **larger sample size is required** to increase the probability of uncovering errors.
- **Detection risk** has an *inverse relationship* to sample size. The more risk an auditor is willing to take that a misstatement will not be identified, the smaller the sample size.
- Because **control risk** has an *indirect relationship* with detection risk, it has a *direct relationship* with sample size. A low assessed level generally indicates a smaller sample is acceptable.
- A **low** expected **frequency** of misstatement means that the auditor expects few errors, which would result in a **smaller sample** size.

Item ID: 13257
Key: C
AUD.CSO.20190701: AUD.003.002.000
AUD.SSO.20190701: Remembering and Understanding:1

Which of the following procedures best addresses the adequacy of presentation and disclosure for inventory of a nonissuer?

A. Obtaining confirmation of inventories that are pledged under loan agreements.

B. Observing the company's physical inventory-taking procedures.

C. Tracing the test counts during the physical inventory to the final inventory listing.

D. Examining the inventory turnover ratio and determining whether it is in line with similar companies in the industry.

To develop an audit plan for specific items on the financial statements (F/S) such as inventory, the auditor will determine which assertions apply, based on whether the assertion is about a class of transactions, an account balance, or a disclosure or presentation item.

Presentation and disclosure address the way facts are presented in the F/S, including the footnotes. For example, presentation assertions would cover whether inventory is presented net of, or separately from, the allowance for inventory obsolescence. Disclosure assertions would cover whether appropriate disclosures have been made of any pledging agreements.

For disclosure and presentation items, the assertions include (RACOU-n):

- Rights and obligations.
- Accuracy and valuation.
- Completeness.
- Occurrence.
- Understandability and classification.

The assess the adequacy of presentation and disclosure of inventory, the following procedures should be taken by the auditor:

- Review disclosures for GAAP compliance.
- **Inquire about pledging**.
- Review purchase commitments.

The remaining answer choices are all procedures that are conducted on either a class of transactions or an account balance, but not presentation and disclosure assertions.

Item ID: 24641
Key: A
AUD.CSO.20190701: AUD.003.003.002
AUD.SSO.20190701: Application:2

The auditor of a nonissuer would most appropriately use reperformance to obtain audit evidence for which of the following purposes?

A. To test the operating effectiveness of a bank reconciliation control.

B. To test whether the amount of FICA tax withheld from an employee's paycheck is appropriate.

C. To determine whether the aging categories on the aged accounts payable trial balance are accurate.

D. To determine the mathematical accuracy of the extended cost amount shown on an invoice sent to a customer.

The auditor performs certain testing designed to identify controls that might reduce the risk of material misstatement (RMM). The auditor will initially *evaluate the design* of a control to determine whether it has the potential of reducing RMM.

If the control has no potential of reducing RMM, the control is not relevant to the audit and no determination will be made as to whether it has been implemented. If it does have the potential to reduce RMM, however, the auditor may test the **operating effectiveness** of the control in order to reduce the need for substantive testing.

As part of testing whether the bank reconciliation process is operating effectively, an auditor might reperform one or more bank reconciliations from the period under audit to see if the auditor's results match those of the original.

To test FICA tax withholding or determine the mathematical accuracy of a sales invoices, an auditor would use recalculation.

To determine whether the aging categories on the aged accounts payable trial balance are accurate, the auditor will inspect the client's accounts payable documentation to determine due dates.

Item ID: 88316
Key: A
AUD.CSO.20190701: AUD.003.003.005
AUD.SSO.20190701: Application:2

In planning an audit, an auditor established materiality at $40,000. The auditor received an attorney's letter indicating that it was probable that each of three lawsuits would be settled for $30,000. Which of the following actions should the auditor take?

A. Add a separate paragraph to the audit report disclosing the contingencies and their amounts.

B. Ask the client to disclose the contingencies in the notes to the financial statements.

C. Ask the client to record the liability for the three contingencies.

D. Add a paragraph to the auditor's opinion disclosing a scope limitation.

The auditor will obtain a letter from each attorney engaged by the client to help address any litigation, claims, or assessments. For losses with only a remote chance of occurring, no further information is needed. If the attorney's response indicates that a loss is reasonably possible or probable, clarification of the estimated loss may be needed to determine the appropriate disclosures and accruals for the contingent losses.

Contingent liabilities that are **probable and estimable** are required to be **accrued and disclosed.** Contingencies are only *disclosed without accrual* if either they are probable but not subject to reasonable estimation or if they are reasonably possible. Remotely possible contingencies are neither accrued nor disclosed.

Here, each of the three lawsuits is probable and estimable, so the auditor should ask the client to record the liability for each of the three contingencies (ie, $90,000 in total).

Item ID: 24545
Key: C
AUD.CSO.20190701: AUD.003.004.004
AUD.SSO.20190701: Application:2

Which of the following is **least** appropriately considered a condition or event that indicates that there could be substantial doubt about an entity's ability to continue as a going concern?

A. Issuance of bonds at the prevailing interest rate.

B. Uneconomic long-term commitments.

C. Arrearages in dividends.

D. An uninsured or underinsured catastrophe.

GAAP requires management to evaluate whether the entity has the ability to continue as a going concern for a reasonable time. A reasonable period of time is typically considered one year from the date on which the F/S are issued.

When considering the risk of a client going out of existence, the primary issues to be considered relate to **cash flow**, since a company is most likely to fail if it is unable to pay its debts as they come due.

Factors that may produce substantial doubt as to the going concern status of the client include:

- Several years of operating losses and/or negative working capital.
- Arrearages in dividends.
- Uneconomic long-term commitments.
- An uninsured or underinsured catastrophe.
- Defaults or restructuring of debts.
- Losses of key customers.

The issuance of bonds at the prevailing interest rate actually indicates that the financial markets have confidence in the entity's ability to succeed long term. If the markets had significant doubts, the bonds would have been sold at a discount.

Item ID: 21761
Key: A
AUD.CSO.20190701: AUD.003.004.005
AUD.SSO.20190701: Remembering and Understanding:1

An auditor of a nonissuer should request that management provide written representations regarding uncorrected misstatements in the financial statements that state

A. The individual and cumulative differences between the auditor's point estimates and the recorded amounts for uncorrected misstatements.

B. Management's acceptance of responsibility for the auditor's opinion, if modified due to the uncorrected misstatements.

C. Whether management believes that the effects of uncorrected misstatements are immaterial, individually and in the aggregate, to the financial statements as a whole.

D. Management's rationale for **not** correcting misstatements noted during the course of the audit.

Written representations are considered a form of audit evidence and are made in the form of a letter written to the auditor. It should be signed by the chief executive officer and chief financial officer of the client, or, in some circumstances, those charged with governance.

The content of the letter will, to some extent, depend on what has taken place during the audit prior to that point. Certain representations, however, will be present in all such letters, including (list is not all-inclusive):

- We acknowledge our responsibility for the design, implementation, and maintenance of internal control to prevent and detect fraud.
- Related party relationships and transactions have been appropriately accounted for and disclosed in accordance with the requirements of U.S. GAAP.
- All events subsequent to the date of the financial statements and for which U.S. GAAP requires adjustment or disclosure have been adjusted or disclosed.
- All financial records that exist have been made available to the auditor.
- There are no pending legal matters with a material impact on the F/S that have not been disclosed to the auditor.
- The effects of **uncorrected misstatements are immaterial**, both individually and in the aggregate, to the financial statements as a whole.

Item ID: 18745
Key: C
AUD.CSO.20190701: AUD.003.006.000
AUD.SSO.20190701: Remembering and Understanding:1

The opinion paragraph in an auditor's report for a nonissuer should include a statement that

A. Includes the word *independent* to clearly indicate that the report is from an independent auditor.

B. Describes the auditor's responsibility for expressing an opinion on the financial statements.

C. Identifies the applicable financial reporting framework and its origin.

D. Indicates that management is responsible for the fair presentation of the financial statements.

The auditor's opinion should state, when expressing an unmodified opinion, that the F/S present fairly, in all material respects, the financial position, results of operations, and cash flows in accordance with the applicable financial reporting framework (AFRF).

The AFRF refers to the system of accounting under which the F/S have been prepared and determines the form and content of the F/S. Two examples of AFRFs include a general-purpose framework (eg, GAAP) or a special-purpose framework (eg, cash basis).

The opinion paragraph identifies the AFRF and its origin. Below is a sample opinion paragraph:

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of X Company as of December 31, 20X1, and the results of its operations and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Item ID: 18107
Key: C
AUD.CSO.20190701: AUD.004.001.002
AUD.SSO.20190701: Remembering and Understanding:1

When an accountant is engaged to prepare financial statements, each of the following requirements applies, **except:**

A. The accountant should verify the completeness of information provided by management for the financial statements.

B. The engagement documentation should include the engagement letter and a copy of the prepared financial statements.

C. The agreed-upon terms of the engagement should include identification of the applicable financial framework to be used.

D. The accountant should include a statement on each page of the financial statements indicating that **no** assurance is provided.

When a CPA is engaged to prepare F/S that will not be compiled, reviewed, or audited by the accountant, the preparation engagement is a nonattest engagement that is subject to SSARS.

As is true of all SSARS engagements, an accountant engaged to prepare F/S for a client is required to adhere to the *General Principles for Engagements Performed in Accordance With SSARS* (AR-C 60). In addition, there are specific requirements that apply to a preparation engagement, including (not all-inclusive):

- The engagement documentation should include the engagement letter and a copy of the prepared financial statements.
- The agreed-upon terms of the engagement should include identification of the applicable financial framework to be used.
- Have an understanding of the client's significant accounting policies.
- The accountant should include a statement on each page of the financial statements indicating that **no** assurance is provided. If this is not a possibility, the accountant should issue a disclaimer stating that no assurance is provided, withdraw from the engagement, or upgrade the engagement to a compilation.

The accountant is not required to verify the accuracy or the completeness of the information from which the F/S are prepared. This is because an accountant performing a preparation is not responsible for the detection of material misstatements, whether due to error or fraud.

Item ID: 94540
Key: A
AUD.CSO.20190701: AUD.004.003.001
AUD.SSO.20190701: Remembering and Understanding:1

Which of the following should a predecessor auditor perform before reissuing a report on financial statements when those financial statements are to be presented on a comparative basis with financial statements audited by another auditor?

A. Obtain representation letters from management of the former client and the successor auditor.

B. Change the date of the reissued report to match the date on which additional procedures were performed.

C. Request attorney's responses to identify any significant litigation subsequent to the original date of the report.

D. Review minutes of board meetings held since the original date of the audit report.

When a **predecessor auditor** examined the F/S of the earlier year, the successor's comparative report of the current year can only express an opinion on the current year since that is the only year the successor audited.

There are two ways of handling the earlier year:

1. The predecessor's report can be reissued and included along with the successor's audit report, or
2. The successor can reference the predecessor's earlier report in an other-matter paragraph.

If the first alternative is chosen, the predecessor must:

- Read the current F/S and compare the F/S that they reported on with their presentation in the current comparative form.
- **Obtain representation letters** from the successor auditor and the client’s management.
- If no adjustment to the prior year F/S is needed, use original report date. If the prior year F.S are restated, then dual-date report.

Item ID: 12239
Key: A
AUD.CSO.20190701: AUD.004.005.001
AUD.SSO.20190701: Remembering and Understanding:1

TASK BASED SIMULATIONS

Item: 500170

Scroll down to complete all parts of this task.

The table below includes unrelated situations encountered by a CPA firm. For each situation identified, select the most appropriate response to the situation.

Situation	Response
A partner is a member of a country club that is a potential new audit client of the CPA firm. The partner has financial decision-making powers at the club, but would not serve as the primary engagement partner.	The firm cannot accept the country club as a new client due to a lack of independence and objectivity.
When performing an attest service (eg, an audit), a covered member must maintain *independence* in **fact and appearance** and cannot have a direct financial interest in the client. Since the partner does have a direct financial interest, the firm cannot accept the country club as a new client.	
A CPA firm just retained a new audit client. The new client's CFO has offered the engagement manager four tickets for personal use to a national, televised, sporting event, along with the use of the client's corporate jet to travel to the event.	The engagement manager cannot accept the tickets in order to maintain the appearance of independence and objectivity.
Accepting gifts or entertainment from a client may create independence threats associated with self-interest, familiarity, and undue influence. If the gifts are reasonable in nature, the threat may be reduced to an acceptable level. However, four tickets to an expensive event, along with the use of a private plane clearly is not reasonable and impairs independence.	
In order to meet the deadline of a client's annual report, the engagement partner issues the final audit report prior to completion of the fieldwork. The company is the CPA firm's largest client.	The firm's lack of internal quality control procedures suggests that the firm is not exercising due care.
AU-C 220 requires a CPA to implement **quality control procedures** at the engagement level to give the auditor reasonable assurance of compliance with professional standards and applicable laws and regulations, and the issuance of a report that is appropriate under the circumstances. Quality control requirements for engagement performance indicate the engagement partner's responsibilities for (among other items) **issuance of a report** that is appropriate under the circumstances. Because the firm issued a report before field work was completed, there must be a lack of quality control procedures such that the firm is not exercising due care.	
A new administrative staff member at a CPA firm sits on the Board of Trustees at a nonissuer audit client. The staff member performs routine clerical functions related to the engagement.	The firm is independent of the client and can issue an unmodified opinion, assuming that no additional issues are identified.
Independence rules apply to covered members and to the members' immediate family. A covered member includes a member of an attest engagement team or an individual in a position to influence the attest engagement. Threats would be at an **acceptable level** if a member's association with a **not-for-profit organization** attest client consisted of serving as an honorary director or **trustee** for an attest client.	

Here, the firm would be considered independent since the member is not involved with decisions in the audit and not in a position to influence those decisions are not covered members and do not compromise the independence of the firm.

A client informed the engagement partner that $190,000 of its inventory is deemed obsolete and is unwilling to adjust the financial statements. Accordingly, the financial statements have not been adjusted. The engagement partner, who has substantial experience in this industry, is aware of the client's position, but has agreed to issue an unmodified opinion on the financial statements. The materiality on the audit is $100,000.	The financial statements are materially misstated, and the engagement partner has not exercised objectivity and integrity.

Making or permitting false and misleading entries in an entity's financial statements; failing to correct materially false and misleading financial statements of an entity with the authority to do so; and signing a document containing false and misleading information create threats to compliance with the rule regarding integrity and objectivity that could not be reduced to an acceptable level. The engagement partner has not exercised objectivity and integrity.

A CPA firm submitted a proposal to perform agreed-upon procedures for Birch Co. The engagement partner's wife is the administrative assistant to the sales team of Birch Co.	The firm can accept Birch Co. as a new client because the firm is independent and objective.

In general, members of a CPA's immediate family, which include the CPA's spouse or spousal equivalent, and all dependents, are required to comply with the independence rules to avoid impairing the independence of the CPA. Any financial interests of immediate family members are attributed to the CPA, including when determining the materiality of an indirect financial interest. However, without impairing a CPA's independence, an immediate family member may be employed by an attest client provided it is not in a key position. Here, an administrative assistant to the sales team is not considered a key position, so the firm can accept the new client.

-- Option List Details --

B1
List

- The firm can accept the country club as a new client because of the scope and nature of the services being provided.
- The firm can accept the country club as a new client because the firm is independent and objective.
- The firm can accept the country club as a new client because the partner will not be involved with the engagement.
- The firm cannot accept the country club as a new client because the client lacks integrity.
- The firm cannot accept the country club as a new client due to a lack of independence and objectivity.
- The firm cannot accept the country club as a new client unless it includes a disclosure of the relationship in the notes to the financial statements.

B2
List

- The engagement manager can accept the tickets provided that this is disclosed in the client representation letter.
- The engagement manager can accept the tickets provided that this is disclosed in the notes to the financial statements.
- The engagement manager can accept the tickets with no effect on due care.
- The engagement manager can accept the tickets with no effect on independence and objectivity.
- The engagement manager cannot accept the tickets in order to exercise due care.
- The engagement manager cannot accept the tickets in order to maintain the appearance of independence and objectivity.

B3
List

- Because the company is the CPA firm's largest client, there is a conflict of interest and a lack of independence.
- The firm's lack of internal quality control procedures suggests that the firm is not exercising due care.
- The firm's lack of internal quality control procedures suggests that the firm is not exercising objectivity.
- The issuance of the audit report is acceptable, as long as the situation is disclosed in the client representation letter.
- The issuance of the audit report is in accordance with the firm's internal professional code of conduct.

B4
List

- The firm is independent of the client and can issue an unmodified opinion, assuming that no additional issues are identified.
- The firm is independent of the client but must issue a modified opinion disclosing the nature of the relationship.
- The firm is not independent of the client and must disclaim an opinion of the financial statements.
- The firm is not independent of the client and must disclose the relationship in the financial statements.
- The firm is not independent of the client and must withdraw from the engagement.

B5
List

- The financial statements are materially misstated, and the engagement partner has exercised due care.
- The financial statements are materially misstated, and the engagement partner has not exercised objectivity and integrity.
- The financial statements are materially misstated, and the engagement partner is not independent.
- The financial statements are not materially misstated, and the engagement partner has exercised due care.
- The financial statements are not materially misstated, and the engagement partner has exercised objectivity and integrity.
- The financial statements are not materially misstated, and the engagement partner is not independent.

B6
List

- The firm can accept Birch Co. as a new client because the firm is independent and objective.
- The firm can accept Birch Co. as a new client, with a disclosure of the relationship in the attestation report.
- The firm cannot accept Birch Co. as a new client due to a lack of independence and objectivity.
- The firm cannot accept Birch Co. as a new client due to a lack of integrity.
- The firm cannot accept Birch Co. as a new client due to the nature and scope of the services being provided.

Exhibits Information

There are no exhibits for this item.

Item: **500697**

An accountant has been engaged to compile a company's financial statements. During the compilation procedures the accountant became aware of a material departure from the financial reporting framework of the company. The company's management agreed that a modification of the compilation report is required, but the accountant is concerned that a modification alone would not be adequate to indicate the deficiencies in the financial statements as a whole. Which paragraph in the professional standards provides the accountant with the engagement requirement when modifications to the compilation report would not be adequate?

Enter your response in the answer fields below. Guidance on correctly structuring your response appears above and below the answer fields.

Type the paragraph here.

Correctly formatted AR-C paragraphs are 1, 2, or 3 digits, preceded in some cases by an upper case letter.

AR-C § 80 . 32

Some examples of correctly formatted AR-C responses are AR-C§12.34, AR-C§12.A34, AR-C§12.A345, AR-C§123.45, AR-C§123.A45

Source: AICPA AR-C 80.32

.32 If the accountant believes that modification of the compilation report is not adequate to indicate the deficiencies in the financial statements as a whole, the accountant should withdraw from the engagement and provide no further services with respect to those financial statements. (Ref: par. .A23) [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

Exhibits Information

There are no exhibits for this item.

Item: **502067**

Scroll down to complete all parts of this task.

A CPA firm is in the process of completing the year 9 audit of a nonissuer client, Bauer Corp., in accordance with generally accepted auditing standards. After the audit staff completed various audit procedures related to accounts payable and accrued expenses, the audit senior is reviewing the workpapers and completing work on the accounts payable and accrued expenses audit program.

Use the selected audit workpapers and the additional information found in the exhibits above to review excerpts of the accounts payable and accrued expenses audit program and update the program as necessary to verify that it is technically accurate.

Control testwork was performed over accounts payable:

- The audit team walked through the approval process for the addition of the new vendor during the year, and no exceptions were noted.
- A sample of 45 invoices were selected to perform a three-way match of payment to approved purchase order, shipping documentation, and invoice, and no exceptions were noted.

Performance materiality for accounts payable and accrued expenses for the year 9 audit has been set at $60,000.

To revise the audit program excerpts, click on each segment of underlined text below and select the needed correction, if any, from the list provided. If the underlined text is already correct in the context of the audit program, select [Original text] from the list.

For the rows requiring you to determine the primary assertions related to an audit procedure, select the list that contains all the relevant primary assertions and only the relevant primary assertions.

Entity: Bauer Corp.	Balance Sheet Date: December 31, year 9		
Primary Assertions	**Audit Procedure**	**Completion Comments**	**W/P Ref**
Existence, completeness, accuracy	Compare the balances in trade accounts payable and purchases with those of prior periods or other expectations. Investigate any unusual fluctuations, considering known changes in client operations.	Accounts payable balance is consistent with the prior year and in line with auditor expectations.	P-30
Existence, completeness, accuracy	Obtain a listing of trade accounts payable as of year end and perform the following: • Agree or reconcile the balance to the general ledger. • Investigate any unusual or old items. • Review a sample of vendors and evaluate their creditworthiness	No unusual items noted per review of accounts payable subledger detail.	P-30
Existence, rights and obligations, accuracy, valuation, cutoff	Perform a search for unrecorded liabilities by performing the following procedures: • Obtain and examine supporting detail for disbursements after the balance sheet date and determine whether the goods or services on the paid invoices were received on or before the balance sheet date. If the answer is "yes," determine whether the liability is recorded. Document the source and selection criteria for items tested. • Inspect files of unprocessed (or unvouchered) invoices, vendor statements, and unmatched receiving documents. If the goods or services were received on or before the balance sheet date, determine whether the liability is included in the general ledger.	Exceptions noted are below performance materiality; therefore, no further audit testwork is necessary.	P-50

Existence, completeness, accuracy, cutoff	Test accrued expenses and other liabilities by performing the following procedures: • Review the working trial balance and determine the accrued expense accounts for which additional testing should be performed. • Test the reasonableness of the accrued expense by performing a predictive test of the amount. • Test the reasonableness of accrued expenses and other liabilities by examining subsequent payments or other supporting documents.	Accruals tested without material exception.	P-75

Answer choices and correct answer (ie, Key) provided by the AICPA

(Note: There are six required responses)

Response 1

Accounts payable balance is consistent with the prior year and in line with auditor expectations.

Choose an option below

- ○ *[Original text]* Accounts payable balance is consistent with the prior year and in line with auditor expectations.
- ○ Accounts payable balance increase is reasonable given the increase in inventory as compared to the prior year.
- ○ Accounts payable balance increased compared to the prior year due to the addition of a new vendor during the year. Given the results of control testwork performed, pass on further audit procedures.
- ○ The company appears to be experiencing cash flow issues, as evidenced from the ratio analysis performed. Perform further procedures to understand the implications on the financial statements.
- ○ The company is managing its working capital needs due to short-term cash constraints. No further testwork is considered necessary.

RESET

CANCEL ACCEPT

Key

The company appears to be experiencing cash flow issues, as evidenced from the ratio analysis performed. Perform further procedures to understand the implications on the financial statements.

year. Given the results of control testwork performed, pass on further audit procedures.

- ◉ The company appears to be experiencing cash flow issues, as evidenced from the ratio analysis performed. Perform further procedures to understand the implications on the financial statements.

RESET

CANCEL ACCEPT

Response 2

- Review a sample of vendors and evaluate their creditworthiness

Choose an option below

- *[Original text]* Review a sample of vendors and evaluate their creditworthiness
- Review the listing for unapproved payments to detect and investigate fraudulent payments.
- Review the listing to identify related party transactions, if any, and gather information for appropriate financial statement disclosure.
- Review the listing to identify whether the three-way match for payment processing has been adequately performed.

RESET

CANCEL ACCEPT

Key

Obtain a listing of trade accounts payable as of year end and perform the following:

- Agree or reconcile the balance to the general ledger.
- Investigate any unusual or old items.
- **Review the listing to identify related party transactions, if any, and gather information for appropriate financial statement disclosure.**

creditworthiness

- Review the listing for unapproved payments to detect and investigate fraudulent payments.
- (selected) Review the listing to identify related party transactions, if any, and gather information for appropriate financial statement disclosure.
- Review the listing to identify whether the three-way match for payment processing has been adequately performed.

RESET

CANCEL ACCEPT

Response 3

No unusual items noted per review of accounts payable subledger detail.

Choose an option below

- *[Original text]* No unusual items noted per review of accounts payable subledger detail.
- Accounts payable balance does not agree to purchase orders approved by management and/or the Board of Directors.
- Audit difference proposed to reclassify debits in accounts payable to accounts receivable as of year end.
- Unapproved vendors are included in accounts payable balance as of year end. Further investigation is required.

RESET

CANCEL ACCEPT

Key

Audit difference proposed to reclassify debits in accounts payable to accounts receivable as of year end.

management and/or the Board of Directors.

- (selected) Audit difference proposed to reclassify debits in accounts payable to accounts receivable as of year end.
- Unapproved vendors are included in accounts payable balance as of year end. Further investigation is required.

RESET

CANCEL ACCEPT

Response 4

Existence, rights and obligations, accuracy, valuation, cutoff

Choose an option below

- ○ *[Original text]* Existence, rights and obligations, accuracy, valuation, cutoff
- ○ Existence, completeness, rights and obligations, accuracy, valuation
- ○ Existence, completeness, rights and obligations, accuracy, cutoff
- ○ Existence, completeness, rights and obligations, valuation

RESET

CANCEL ACCEPT

Key

Existence, completeness, rights and obligations, accuracy, cutoff ✓

- ○ Existence, completeness, rights and obligations, accuracy, valuation
- ◉ Existence, completeness, rights and obligations, accuracy, cutoff
- ○ Existence, completeness, rights and obligations, valuation

RESET

CANCEL ACCEPT

Response 5

Exceptions noted are below performance materiality; therefore, no further audit testwork is necessary.

Choose an option below

- *[Original text]* Exceptions noted are below performance materiality; therefore, no further audit testwork is necessary.
- Exception noted; $31,400 carried to summary of audit differences.
- Exceptions noted; $74,400 carried to summary of audit differences.
- Exceptions noted; $93,500 carried to summary of audit differences.
- Exceptions noted; $134,900 carried to summary of audit differences.
- Exceptions noted; $167,900 carried to summary of audit differences.
- Exceptions noted; understand the cause of the exceptions and perform additional procedures to determine whether an adjustment is necessary.

RESET

CANCEL ACCEPT

Key

Exceptions noted; understand the cause of the exceptions and perform additional procedures to determine whether an adjustment is necessary.

- Exceptions noted; $134,900 carried to summary of audit differences.
- Exceptions noted; $167,900 carried to summary of audit differences.
- (selected) Exceptions noted; understand the cause of the exceptions and perform additional procedures to determine whether an adjustment is necessary.

RESET

CANCEL ACCEPT

Response 6

Accruals tested without material exception.

Choose an option below

- ○ *[Original text]* Accruals tested without material exception.
- ○ Accrued salaries and wages were inconsistent with auditor expectation. See summary of audit differences for adjustment proposed.
- ○ Exception noted related to accrued legal settlement. See summary of audit differences for adjustment proposed.
- ○ Exception noted related to accrued professional fees. See summary of audit differences for adjustment proposed.
- ○ Exception noted related to accrued warranty expense. See summary of audit differences for adjustment proposed.

RESET

CANCEL ACCEPT

Key 2

Exception noted related to accrued legal settlement. See summary of audit differences for adjustment proposed.

and wages were inconsistent with auditor expectation. See summary of audit differences for adjustment proposed.

- ◉ Exception noted related to accrued legal settlement. See summary of audit differences for adjustment proposed.
- ○ Exception noted related to accrued professional fees.

RESET

CANCEL ACCEPT

Key 1

Accruals tested without material exception.

Choose an option below

- ◉ *[Original text]* Accruals tested without material exception.
- ○ Accrued salaries and wages were inconsistent with auditor expectation. See summary of audit differences for adjustment proposed.
- ○ Exception noted related to accrued legal settlement

RESET

CANCEL ACCEPT

Exhibits Information

Exhibits included in this item

Exhibit for Item: **502067**

Exhibit 1: **Planning Meeting Notes P-10**

Bauer, Inc.
Planning meeting notes - Accounts payable and accrued expenses Year ended December 31, year 9

Purpose:
The purpose of this memorandum is to document the planning meeting discussion that was held with the controller and senior manager of procurement on November 19, year 9, specific to our audit of accounts payable and accrued expenses as of December 31, year 9.

The following matters were discussed:

1. Bauer added a new vendor, Skyline Equipment, to the approved vendor list during year 9.
2. Bauer has been experiencing quality issues with products fulfilled by its vendor, Moore, Inc. The quality issues are so important that Bauer has slowed down ordering from this vendor until Moore is able to demonstrate that its quality control processes are operating effectively. Moore has offered refunds to its customers for the amount of any overpayments.

No other significant matters were brought to our attention during the planning meeting.

Exhibit for Item: **502067**

Exhibit 2: **Accounts Payable Detail by Vendor P-30**

Bauer Corp.			**P-30**
Accounts payable detail by vendor			
As of December 31			
Vendor	**Credit/(Debit) Balance year 9**	**Credit/(Debit) Balance year 8**	
Brooks Engineering	61,620	39,840	
Cherry Corp.	84,350	68,435	
Davis & Davis Consultants	59,850	37,540	
Fusion, Inc.	172,340	104,300	
Honeymade, Inc.	78,455	49,560	
Ivy Machines Co.	214,670	140,450	
JFS, LLP	95,890	66,450	
Keller, Klein, & Pascal, LLP	247,120	197,840	
Lumber Co.	216,340	178,540	
Maple Glen Distributors	152,000	93,000	
Moore, Inc.	(100,000)	207,000	
Muscat Suppliers	111,500	80,400	
Servers & More	66,000	40,000	
Skyline Equipment	123,890	0	
Spruce Contractors	57,990	32,890	
XYZ Corporation	198,670	121,470	
Total	**1,840,685**	**1,457,715**	**R**
	***f*, G/L**	***f*, PY**	
f	Foots, without exception		
G/L	Agrees to balance per the general ledger, without exception.		
PY	Agrees to prior-year workpapers and approved vendor listing, without exception.		
R	Accounts payable balance appears reasonable compared to prior year, pass on further audit procedures.		

Exhibit for Item: **502067**

Exhibit 3: **Search for Unrecorded Liabilities P-50**

Bauer Corp.							**P-50**
Search for unrecorded liabilities			**Prepared by**: Audit Staff				
Y/E: December 31, year 9			**Reviewed by**: ________				
Note: Disbursements greater than $30,000 were selected for testwork.							
			Relates to		**Properly included in accounts payable**	**Properly excluded from accounts payable**	
Date	**Payee**	**Amount**	**Year 9**	**Year 10**			**T/M**
1/4/year 10	Atlantis Realty Group	124,230		x		124,230	
1/11/year 10	Plenty Insurance Co.	45,000		x		45,000	
1/11/year 10	Davis & Davis	39,750	x		39,750		
1/11/year 10	Spruce Contractors	50,200	x		50,200		
1/18/year 10	Ace, Inc.	93,500	x			93,500	**A**
1/18 year 10	Hollyhedge Corp.	41,400	x		0		**B**
1/25/year 10	JFS LLP	49,450		x		49,450	

1/25/year 10	Skyline Equipment	56,790		x		56,790	
2/1/year 10	ABC Janitorial Services	30,400		x		30,400	
2/1/year 10	Atlantis Realty Group	124,230		x		124,230	
2/1/year 10	Servers & More	99,000	x	x	66,000	33,000	C
2/1/year 10	Cherry Corp.	110,340		x		110,340	
2/8/year 10	Honeymade, Inc.	73,250		x		73,250	
A	Disbursement relates to year 9 professional services provided to Bauer. See workpaper P-85 for accrued professional fees.						
B	Disbursement relates to landscaping fees to remove trees and debris caused by major storm during December, year 9. No ledger accrual was recorded as of December 31, year 9.						
C	Disbursement relates to quarterly IT services provided for the period November 1, year 9, through January 31, year 10.						

Exhibit for Item: **502067**

Exhibit 4: **Accrued Expense Lead Sheet P-75**

Bauer Corp.					**P-75**
Accrued Expenses Lead Sheet				**Prepared by: Staff Auditor**	
Y/E: December 31, year 9				**Reviewed by: ____________**	
		Year 9	**Year 8**	**$ Change**	**% Change**
Accrued salaries and wages	**A**	137,500	200,000	(62,500)	(31.25)
Accrued professional fees	**P-85**	269,500	198,000	71,500	36.11
Accrued interest	**M**	5,500	5,900	(400)	(6.78)
Accrued taxes	**M**	17,430	18,920	(1,490)	(7.88)
Accrued warranty expense	**R**	205,560	194,340	11,220	5.77
Accrued legal settlement	**V**	90,000	0	90,000	100
Total		**725,490**	**617,160**	**108,330**	**17.55**
		f, G/L	**f, G/L, PY**	**Rx**	**Rx**
	f	Foots, without exception			
	G/L	Agreed to general ledger as of December 31, year 9, without exception			
	PY	Agreed to prior-year workpapers, without exception			
	Rx	Recalculated, without exception			
	A	Per review of subsequent payroll register, total payroll expense for the period Monday, December 26, year 9, through Friday, January 6, year 10, was $275,000.			
	R	Accrual reasonable given increase in sales volume. Recalculated based on historical 12-month rolling average warranty rate. Accordingly, pass on further audit procedures.			
	V	Vouched to subsequent legal settlement payment of $100,000 on January 28, year 10, for year 7 workers' compensation claim paid.			
	M	These amounts are immaterial and tested by other audit procedures. No additional testwork is necessary.			

Exhibit for Item: **502067**

Exhibit 5: **Reconciliation of Accrued Professional Fees P-85**

Bauer Corp. **Accrued Professional Fees** **As of December 31, year 9**	**PBC**	**P-85**
Balance per general ledger as of December 31, year 9	$ 269,500	**G/L**
Less:		
Cigital Consulting	$(100,000)	**V**
BOD fees	(25,000)	**R**
Ace, Inc.	(93,500)	**V**
Jackson, Wyatt, & Hunter, LLP	(51,000)	**V**
Difference:	$ - 0 -	
G/L – Agreed to general ledger balance as of December 31, year 9, without exception.		
V – Vouched subsequent cash disbursement for services related to year 9, without exception.		
R – BOD fees consistent with prior year; pass on further audit procedures.		

Exhibit for Item: **502067**

Exhibit 6: **Other Information**

Key financial information obtained during planning:

- Sales for the 11 months ended November 30, year 9, have increased 5% as compared to sales for the 11 months ended November 30, year 8.
- Inventory has increased 4% as of November 30, year 9, as compared to December 31, year 8.
- The average accounts payable turnover ratio has increased from 28 days as of December 31, year 8, to 44 days as of November 30, year 9.

Acquisition – Harvest Corporation:
Per inquiry with the Chief Financial Officer, the company acquired a 10% noncontrolling interest in Harvest Corporation during March, year 9. Information corroborated by review of the Board of Directors minutes by the audit team from March, year 9.

Correct answers and explanations

Entity: Bauer Corp.	Balance Sheet Date: December 31, year 9		
Primary Assertions	**Audit Procedure**	**Completion Comments**	**W/P Ref**
Existence, completeness, accuracy	Compare the balances in trade accounts payable and purchases with those of prior periods or other expectations. Investigate any unusual fluctuations, considering known changes in client operations.	Accounts payable balance is consistent with the prior year and in line with auditor expectations.	P-30
Response 1 Exhibit 6 states that the accounts payable (A/P) turnover ratio has increased from 28 days as of December 31, Year 8 to 44 days as of November 30, Year 9. That is a 57% increase in the number of days it takes to pay of an A/P. That significant an increase is an indication that the entity may be experiencing cash flow issues.		**The company appears to be experiencing cash flow issues, as evidenced from the ratio analysis performed. Perform further procedures to understand the implications on the financial statements.**	
Existence, completeness, accuracy	Obtain a listing of trade accounts payable as of year end and perform the following: • Agree or reconcile the balance to the general ledger. • Investigate any unusual or old items. • Review a sample of vendors and evaluate their creditworthiness	No unusual items noted per review of accounts payable subledger detail.	P-30
Response 2 Credit worthiness is a concern for accounts receivables (A/R) as it affects the risk on uncollectible accounts. For vendors, it is more important to determine if any related-party transactions exist, which might have occurred at unusual, favorable terms. These transactions would need to be disclosed in the notes.		**Review the listing to identify related party transactions, if any, and gather information for appropriate financial statement disclosure.**	
Response 3 According to Exhibit 1, Bauer has been experiencing quality issues with Moore, and Moore is offering refunds to customers. The debit A/P balance for Moore, Inc. represents the amount of the refunds that Moore needs to reimburse Bauer for. Given that the performance materiality level is $60,000, the $100,000 debit balance should be reclassified to A/R. (Note: performance		**Audit difference proposed to reclassify debits in accounts payable to accounts receivable as of year end.**	

materiality is the minimum level set for identified misstatements.)			
Existence, rights and obligations, accuracy, valuation, cutoff	Perform a search for unrecorded liabilities by performing the following procedures: • Obtain and examine supporting detail for disbursements after the balance sheet date and determine whether the goods or services on the paid invoices were received on or before the balance sheet date. If the answer is "yes," determine whether the liability is recorded. Document the source and selection criteria for items tested. • Inspect files of unprocessed (or unvouchered) invoices, vendor statements, and unmatched receiving documents. If the goods or services were received on or before the balance sheet date, determine whether the liability is included in the general ledger.	Exceptions noted are below performance materiality; therefore, no further audit testwork is necessary.	P-50

Response 4 The auditing objectives for accounts payable include: • Rights & obligations: payables are legitimate obligations of the entity. • Accuracy: payables are reported in the appropriate amounts. • Cutoff: there are no unrecorded liabilities. • Existence: payables actually exist.	Existence, completeness, rights and obligations, accuracy, cutoff	
Response 5 As shown on workpaper P-50, several discrepancies were noted. $93,500 was excluded from A/P yet was for services provided in Year 9 (tick mark A). Another $41,400 should have been accrued but was not (tick mark B). These two items exceed the performance materiality of $60,000. Therefore, exceptions were noted and should be further investigated to determine if an adjustment is required.	Exceptions noted; understand the cause of the exceptions and perform additional procedures to determine whether an adjustment is necessary.	

Existence, completeness, accuracy, cutoff	Test accrued expenses and other liabilities by performing the following procedures: • Review the working trial balance and determine the accrued expense accounts for which additional testing should be performed. • Test the reasonableness of the accrued expense by performing a predictive test of the amount. • Test the reasonableness of accrued expenses and other liabilities by examining subsequent payments or other supporting documents.	Accruals tested without material exception.	P-75
Response 6 Per worksheet P-75, a lawsuit from year 7 was settled in year 10 for $100,000. The accrual for the loss in year 9 was $90,000. There is not sufficient information provided to determine if the accrual should have been recorded in year 7 or year 8. If the attorney stated that chances of a settlement against the client were remote, then no accrual would have been required. Nevertheless, an exception should be noted on the summary of audit differences for follow-up and potential adjustment.		Exception noted related to accrued legal settlement. See summary of audit differences for adjustment proposed.	

Blueprint Information

CSO: 002.005.002

Skill: Analysis

Representative task: Analyze the potential impact of identified risks at the relevant assertion level for significant classes of transactions, account balances and disclosures in an entity's financial statements, taking account of the controls the auditor intends to test.

Item: **506396**

Scroll down to complete all parts of this task.

Ironstone, LLP is auditing the financial statements of Candlewood Co., a nonissuer, as of and for the year ended December 31, year 6. The engagement team interviewed Candlewood staff and inspected documents in order to obtain an understanding of the company's system of internal control. Documentation of the interviews and supporting information is found in the exhibits above. The engagement team is documenting its understanding of the design of internal controls related to the purchasing cycle in the document below. Review the exhibits and revise the document below as necessary.

To revise the document, click on each segment of underlined text below and select the needed correction, if any, from the list provided. If the underlined text is already correct in the context of the document, select [Original Text] from the list.

Control objective (relevant assertion)	Risk of failing to achieve objective	Control activity in place	Design conclusion
Only purchase goods or services from approved vendors. (existence, occurrence, and valuation)	Purchases are made at an inflated price, or of substandard quality, or purchase orders are unfilled.	New vendors must be approved by the controller and CFO.	The control is not effectively designed, or no control activity is in place.
Only execute purchases of goods or services pursuant to valid purchase orders. rights and obligations	Unapproved purchase orders are processed.	Purchase orders must be approved by the controller, the CEO, or the CFO.	The control is effectively designed.
Receive ordered goods and accurately record the receipt. (accuracy)	Incorrect goods or quantity of goods are received.	The receiving clerk agrees the goods received to the approved purchase order.	The control is effectively designed.
Record purchases in the proper accounting period. (cutoff)	Received orders have items missing.	The receiving clerk agrees all goods received to approved purchase orders. The controller reviews all purchasing and receiving activity weekly to determine whether goods were recorded when received.	The control is effectively designed.
Payment is only issued for goods received pursuant to approved purchase orders. (occurrence/ existence)	Payments are processed for unauthorized orders or to vendors that fail to deliver goods.	No control activity is in place; the company should have a process to authorize payments.	The control is not effectively designed, or no control activity is in place.

Key

No control activity is in place; the company should have formal controls over the bidding and approval process for new vendors.

obtained from a minimum of three bidders prior to selecting a new vendor.

- (selected) No control activity is in place; the company should have formal controls over the bidding and approval process for new vendors.
- No control activity is in

RESET

CANCEL ACCEPT

Response 1

New vendors must be approved by the controller and CFO.

Choose an option below

- *[Original text]* New vendors must be approved by the controller and CFO.
- A copy of the approved purchase order is sent to the vendor for fulfillment.
- Bids must be obtained from a minimum of three bidders prior to selecting a new vendor.
- No control activity is in place; the company should have formal controls over the bidding and approval process for new vendors.
- No control activity is in place; the company should have sequentially numbered purchase orders.

RESET

CANCEL ACCEPT

Response 2

Only execute purchases of goods or services pursuant to valid purchase orders. rights and obligations

Choose an option below

- *[Original text]* rights and obligations
- cutoff
- occurrence
- presentation
- valuation

RESET

CANCEL ACCEPT

Key

Only execute purchases of goods or services pursuant to valid purchase orders. **occurrence**

Choose an option below

- *[Original text]* rights and obligations
- cutoff
- occurrence (selected)
- presentation
- valuation

RESET

CANCEL ACCEPT

Response 3

The control is effectively designed.

Choose an option below

- *[Original text]* The control is effectively designed.
- The control is not effectively designed; individuals providing approval of the transaction should be independent of the requester.
- The control is not effectively designed; the purchase order is not mathematically accurate.
- The control is not effectively designed; the purchase order obtained was not approved by the controller, the CEO, or the CFO.

RESET

CANCEL ACCEPT

Key

The control is not effectively designed; individuals providing approval of the transaction should be independent of the requester.

- The control is effectively designed.
- (selected) The control is not effectively designed; individuals providing approval of the transaction should be independent of the requester.
- The control is

RESET

CANCEL ACCEPT

Response 4

The control is effectively designed.

Choose an option below

- *[Original text]* The control is effectively designed.
- The control is not effectively designed; agreeing goods received to the purchase order should be performed by an individual independent of the receiving department for proper segregation of duties.
- The control is not effectively designed; the purchase order obtained was not approved by the controller, the CEO, or the CFO.
- The control is not effectively designed; the quantity of the goods received does not agree to the purchase order.
- The control is not effectively designed; there is no evidence indicating that the goods received were agreed to the purchase order.

RESET

CANCEL ACCEPT

Key

The control is effectively designed.

Choose an option below

- (selected) *[Original text]* The control is effectively designed.
- The control is not effectively designed; agreeing goods received to the purchase order should be performed

RESET

CANCEL ACCEPT

Response 5

Received orders have items missing.

Choose an option below

- *[Original text]* Received orders have items missing.
- Duplicate receipts are processed.
- Orders received with damaged goods are accepted.
- Purchase price per the invoice is inaccurate.
- Received orders are recorded in the incorrect accounting period.

RESET

CANCEL ACCEPT

Key

Received orders are recorded in the incorrect accounting period.

have items missing.
- Duplicate receipts are processed.
- Orders received with damaged goods are accepted.
- Purchase price per the invoice is inaccurate.
- (selected) Received orders are recorded in the incorrect accounting period.

RESET

CANCEL ACCEPT

Response 6

No control activity is in place; the company should have a process to authorize payments.

Choose an option below

- *[Original text]* No control activity is in place; the company should have a process to authorize payments.
- A three-way match of the purchase order, receiving report, and invoice is performed prior to payment.
- Checks in excess of $25,000 require dual signatures of the CEO and the CFO.
- No control activity is in place; the company should perform a three-way match of the purchase order, receiving report, and invoice prior to payment.
- No control activity is in place; the company should review the AP aging report to ensure that payments are made within terms.

RESET

CANCEL ACCEPT

Key

No control activity is in place; the company should perform a three-way match of the purchase order, receiving report, and invoice prior to payment.

of the CEO and the CFO.

- (selected) No control activity is in place; the company should perform a three-way match of the purchase order, receiving report, and invoice prior to payment.
- No control activity is in place; the company should

RESET

CANCEL ACCEPT

Exhibits Information

Exhibits included in this item	
	1. **Purchasing Cycle Understanding Document** 2. **Purchase Order**

Exhibit for Item: **506396**

Exhibit 1: **Purchasing Cycle Understanding Document**

C-01

Candlewood Co.
Purchasing cycle understanding document
Year ended December 31, year 6

Procedure: The audit senior interviewed the purchasing manager, receiving manager, and AP manager to gain an understanding of the purchasing cycle. Based on the processes described in the staff interviews, the audit senior obtained and inspected relevant documentation related to a purchase from Portofino Furniture Co.

Title of person interviewed	Auditor's inquiry	Management's response	Documents obtained & inspected
Purchasing Manager	What is the process for generating and processing a purchase order?	When a department identifies a need for a purchase, that department will notify the purchasing department by preparing a purchase requisition. I receive the requisition and select the appropriate vendor from the vendor list and prepare a sequentially numbered purchase order. I send the purchase order to the controller, the CEO, or the CFO, for approval. The approved purchase order is sent to the vendor for fulfillment. A copy of the approved purchase order is also sent to the receiving department.	Obtained and inspected Portofino Furniture Co. purchase order #150606 (**C-02**), which was requested by T. Jones and approved by T. Jones (Controller).
	What is the process for approving a new vendor?	In instances when a purchase needs to be made from a new vendor, I usually request several bids before selecting a vendor. The controller will take a look at the bids and my selection before we submit a purchase order for fulfillment.	
Receiving Manager	What is the process when a purchase is received?	A receiving clerk accepts delivery of the goods or supplies and agrees the quantity and item number of the goods received to the approved purchase order and prepares a receiving report. The receipt and agreement of the goods is evidenced on the purchase order by the signature of the receiving clerk. The goods or supplies are sent to the department that requested them. The controller reviews all purchasing and receiving activity weekly to ensure that goods are recorded when received.	Obtained and inspected Portofino Furniture Co. purchase order #150606 (**C-02**).

AP Manager	What is the process for recording an invoice?	The accounts payable (AP) department receives the invoice directly from the vendor. The accounts payable subsidiary ledger is updated when the staff accountant enters the invoice into the ERP system. The accounts payable subsidiary ledger is reconciled to the general ledger by the AP manager and reviewed and approved by the controller monthly.	Obtained and inspected Portofino Furniture Co. invoice #00019376 dated 11/11/year 6, which agreed to purchase order #150606 and check #5284.
	How are invoices paid?	The AP Manager reviews the AP aging, selects invoices due to be paid based on payment terms, and prepares the payments. The invoices are approved for payment by the CEO, the CFO, or both. Checks in excess of $25,000 require dual signatures, from both the CEO and the CFO. The invoice is marked as paid indicating the general ledger account, the date, and the approver of the invoice. After payment, the invoice is filed in the paid invoices file.	Obtained and inspected check #5284 in the amount of $37,630.00, payable to Portofino Furniture Co. paid on 12/23/year 6. The check was properly signed by both the CEO and CFO, and the check amount matched the invoice amount.

Exhibit for Item: **506396**

Exhibit 2: **Purchase Order**

C-02

PURCHASE ORDER

Candlewood Co.
150 Long Branch
Marville, PA 18955
758-555-9165

Date: 10/25/year 6

To:	Ship To:
Portofino Furniture Co. 302 North Main Road Marville, PA 18955 758-555-8954	Candlewood Co. 150 Long Branch Marville, PA 18955 758-555-9165

Order Date:	Requestor	Purchase Order #	f.o.b.	Payment Terms
10/25/year 6	T. JONES	150606	Shipping point	60 days from receipt

Quantity	Item No.	Description	Unit Price ($)	Total ($)
1	A367	Boardroom table	23,500	23,500
12	F00259	Boardroom chairs	1,000	12,000
			Subtotal	35,500
			Sales Tax (6%)	2,130
			Shipping and Handling	-
			Other	-
			Total	**37,630**

Enter this order in accordance with the prices, f.o.b. terms, and payment terms listed above.

Purchase order approved:	T. Jones, Controller 10/25/year 6
Receipt and agreement of goods:	A. Gilbert, Receiving Clerk 11/11/year 6

** Note: The owner of Portofino is an old friend and is giving us a great price! No bids are necessary, add this new vendor to the list. - T. Jones

CORRECT ANSWERS AND EXPLANATIONS

Control objective (relevant assertion)	Risk of failing to achieve objective	Control activity in place	Design conclusion
Only purchase goods or services from approved vendors. (existence, occurrence, and valuation)	Purchases are made at an inflated price, or of substandard quality, or purchase orders are unfilled.	New vendors must be approved by the controller and CFO.	The control is not effectively designed, or no control activity is in place.

Response 1 There is not control activity in place – new vendors are **not** approved by the controller and CFO. Exhibit 1 shows management's explanation for the process of approving a new vendor – the purchasing manager requests bids, and the controller approves the purchase order (PO) for the selected bid. Exhibit 2 has a note at the bottom of the PO stating the vendor is an old friend, no bids are necessary. The vendor was added to the list of approved vendors with no control activity.	No control activity is in place; the company should have formal controls over the bidding and approval process for new vendors.

Only execute purchases of goods or services pursuant to valid purchase orders. rights and obligations	Unapproved purchase orders are processed.	Purchase orders must be approved by the controller, the CEO, or the CFO.	The control is effectively designed.

Response 2 The assertion to only execute purchases of goods or services pursuant to valid purchase orders is the occurrence assertion, not the rights and obligations (R&O) assertion. R&O focuses on ownership of the inventory, which hasn't happened yet. The Occurrence assertion verifies that the PO is valid.	Only execute purchases of goods or services pursuant to valid purchase orders. occurrence
Response 3 Purchase order 150606 was requested and approved by the same person (T. Jones). For the purchase order approval process to function as a meaningful control, the person responsible for requesting the PO cannot also approve that PO. In this case, although the PO was approved by the controller per company policy, it was also requested by the controller, meaning that the approval process was not meaningful.	The control is not effectively designed; individuals providing approval of the transaction should be independent of the requester.

Receive ordered goods and accurately record the receipt. (accuracy)	Incorrect goods or quantity of goods are received.	The receiving clerk agrees the goods received to the approved purchase order.	The control is effectively designed.

Response 4

Exhibit 1 explains the control currently in place. The receiving clerk agrees the quantity and item number of the goods received to the approved PO and signs the PO to indicate the control was performed. The PO shown as Exhibit 2 includes the receiving clerk's notation. The control was effectively designed.

The control is effectively designed. ✓

Record purchases in the proper accounting period. (cutoff)	Received orders have items missing.	The receiving clerk agrees all goods received to approved purchase orders. The controller reviews all purchasing and receiving activity weekly to determine whether goods were recorded when received.	The control is effectively designed.

Response 5

The risk of failing to achieve the objective does not align with the relative assertion being tested. The assertion is that purchases are recorded in the proper accounting period (ie, proper cutoff). The appropriate risk for this assertion is the received orders are recorded in the incorrect accounting period.

Received orders are recorded in the incorrect accounting period. ✓

Payment is only issued for goods received pursuant to approved purchase orders. (occurrence/ existence)	Payments are processed for unauthorized orders or to vendors that fail to deliver goods.	No control activity is in place; the company should have a process to authorize payments.	The control is not effectively designed, or no control activity is in place.

Response 6

Prior to approval for payment, a three-way match should be performed between the PO, the receiving report, and the invoice to ensure that payment is only issued for goods received pursuant to approved POs. As noted on Exhibit 1, the AP manager selects invoices for payment based on the payment terms and prepares the payment. No three-way match is performed. This creates the risk that unauthorized payments may be processed. There is no control activity in place.

No control activity is in place; the company should perform a three-way match of the purchase order, receiving report, and invoice prior to payment. ✓

Blueprint Information

CSO: 002.003.002

Skill: Evaluation

Representative task: Evaluate whether internal controls relevant to an audit of an entity's financial statements, including an audit of an entity's internal controls, are effectively designed and placed in operation.