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CPA Auditing and Attestation Exam

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Topic Break Down

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QUESTION NO: 1

As a result of tests of controls, an auditor assesses control risk too high. This incorrect assessment most likely occurred because:

- A. Control risk based on the auditor's sample is less than the true operating effectiveness of the client's control activity.
- B. The auditor believes that the control activity relates to the client's assertions when, in fact, it does not.
- C. The auditor believes that the control activity will reduce the extent of substantive testing when, in fact, it will not.
- D. Control risk based on the auditor's sample is greater than the true operating effectiveness of the client's control activity.

ANSWER: D**Explanation:**

Choice "d" is correct. The risk of assessing control risk too high is the risk that the assessed level of control risk based on the sample is greater than the true risk based on the actual operating effectiveness of the control.

Choice "a" is incorrect. The risk of assessing control risk too low is the risk that the assessed level of control risk based on the sample is less than the true risk based on the actual operating effectiveness of the control.

Choice "b" is incorrect. Assessing control risk too high relates to an incorrect evaluation of risk by the auditor, not to whether the control activity relates to the client's assertions.

Choice "c" is incorrect. If the auditor believes that a control activity will reduce the extent of substantive testing when, in fact, it will not, this implies that the control risk based on the auditor's sample was less than the true risk based on the actual operating effectiveness of the control. This would be an example of assessing control risk too low, not too high.

QUESTION NO: 2

Before accepting an audit engagement, a successor auditor should make specific inquiries of the predecessor auditor regarding:

- A. Disagreements the predecessor had with the client concerning auditing procedures and accounting principles.
- B. The predecessor's evaluation of matters of continuing accounting significance.
- C. The degree of cooperation the predecessor received concerning the inquiry of the client's lawyer.
- D. The predecessor's assessments of inherent risk and judgments about materiality.

ANSWER: A**Explanation:**

Choice "a" is correct. Before accepting an audit engagement, a successor auditor should make specific inquiries of the predecessor auditor regarding disagreements the predecessor had with the client concerning auditing procedures and accounting principles.

Choice "b" is incorrect. The successor auditor may make specific inquiries of the predecessor auditor regarding the predecessor's evaluation of matters of continuing accounting significance, but this would occur after accepting the engagement.

Choice "c" is incorrect. The successor auditor may make specific inquiries of the predecessor auditor regarding the degree of cooperation the predecessor received concerning the inquiry of the client's lawyer, but this would occur after accepting the engagement.

Choice "d" is incorrect. The successor auditor would generally come to his or her own conclusions regarding assessments of inherent risk and judgments about materiality without consulting the predecessor auditor.

QUESTION NO: 3

The existence of audit risk is recognized by the statement in the auditor's standard report that the auditor:

- A. Obtains reasonable assurance about whether the financial statements are free of material misstatement.
- B. Assesses the accounting principles used and also evaluates the overall financial statement presentation.
- C. Realizes some matters, either individually or in the aggregate, are important while other matters are not important.
- D. Is responsible for expressing an opinion on the financial statements, which are the responsibility of management.

ANSWER: A**Explanation:**

Choice "a" is correct. The existence of audit risk is recognized by the statement in the auditor's standard report that the auditor obtains "reasonable assurance" (as opposed to absolute assurance) about whether the financial statements are free of material misstatement. The existence of audit risk (the risk that the auditor may unknowingly fail to appropriately modify his or her opinion on materially misstated financial statements) is implied in this statement.

Choice "b" is incorrect. Assessing the accounting principles used and evaluating the overall financial statement presentation relate to determining that the statements have been prepared in conformity with GAAP, not to recognizing the existence of audit risk.

Choice "c" is incorrect. Realizing that some matters are more important than others illustrates the concept of materiality; however, this is not a statement included in the auditor's standard report. Choice "d" is incorrect. Indicating that the financial statements are the responsibility of management while the auditor's responsibility is to express an opinion on those financial statements delineates responsibility rather than illustrating the concept of audit risk.

QUESTION NO: 4

This question presents independent factual situations an auditor might encounter in conducting an audit. List B represents the report modifications (if any) that would be necessary. Select as the best answer for each item, the action the auditor normally would take. The report modifications in List B may be selected once, more than once, or not at all.

Assume:

- The auditor is independent.
- The auditor previously expressed an unqualified opinion on the prior year's financial statements.
- Only single-year (not comparative) statements are presented for the current year.
- The conditions for an unqualified opinion exist unless contradicted in the factual situations.
- The conditions stated in the factual situations are material.
- No report modifications are to be made except in response to the factual situation.

Item to Be Answered

An entity discloses in the notes to the financial statements certain lease obligations. The auditor believes that the failure to capitalize these leases is a departure from generally accepted accounting principles.

List B

Report Modifications

- A.** Describe the circumstances in an explanatory paragraph preceding the opinion paragraph without modifying the three standard paragraphs.
- B.** Describe the circumstances in an explanatory paragraph following the opinion paragraph without modifying the three standard paragraphs.
- C.** Describe the circumstances in an explanatory paragraph preceding the opinion paragraph and modify the opinion paragraph.
- D.** Describe the circumstances in an explanatory paragraph following the opinion paragraph and modify the opinion paragraph.
- E.** Describe the circumstances in an explanatory paragraph preceding the opinion paragraph and modify the scope and opinion paragraphs.
- F.** Describe the circumstances in an explanatory paragraph following the opinion paragraph and modify the scope and opinion paragraphs.
- G.** Describe the circumstances within the scope paragraph without adding an explanatory paragraph.
- H.** Describe the circumstances within the opinion paragraph without adding an explanatory paragraph.
- I.** Describe the circumstances within the scope and opinion paragraphs without adding an explanatory paragraph.
- J.** Issue the standard auditor's report without modification.

ANSWER: C

Explanation:

Choice "C" is the correct modification. The circumstances should be described in an explanatory paragraph preceding the opinion paragraph and the opinion paragraph should be modified.

QUESTION NO: 5

This question presents independent factual situations an auditor might encounter in conducting an audit. List A represents the types of opinions the auditor ordinarily would issue. Select as the best answer for this item, the action the auditor normally would take. The types of opinions in List A may be selected once, more than once, or not at all.

Assume:

- The auditor is independent.
- The auditor previously expressed an unqualified opinion on the prior year's financial statements.
- Only single-year (not comparative) statements are presented for the current year.
- The conditions for an unqualified opinion exist unless contradicted in the factual situations.
- The conditions stated in the factual situations are material.
- No report modifications are to be made except in response to the factual situation.

Item to Be Answered

Due to recurring operating losses and working capital deficiencies, an auditor has substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time.

However, the financial statement disclosures concerning these matters are adequate.

List A

Types of Options

- A.** An "except for" qualified opinion.
- B.** An unqualified opinion.
- C.** An adverse opinion.
- D.** A disclaimer of opinion.
- E.** Either an "except for" qualified opinion or an adverse opinion.
- F.** Either a disclaimer of opinion or an "except for" qualified opinion.
- G.** Either an adverse opinion or a disclaimer of opinion.

ANSWER: B

Explanation:

Choice "B" is the correct opinion. In a going concern situation that is properly disclosed, an unqualified opinion should be issued.

QUESTION NO: 6

An accountant has been asked to issue a review report on the balance sheet of a nonissuer without reporting on the related statements of income, retained earnings, and cash flows. The accountant may issue the requested review report only if:

- A. The balance sheet is not to be used to obtain credit or distributed to the entity's creditors.
- B. The balance sheet is part of a comprehensive personal financial plan developed to assist the entity.
- C. There have been no material changes during the year in the entity's accounting principles.
- D. The scope of the accountant's inquiry and analytical procedures has not been restricted.

ANSWER: D

Explanation:

Choice "d" is correct. A review engagement may involve reporting on only one financial statement, provided the scope of the engagement was not limited.

Choice "a" is incorrect. A review engagement may involve reporting on only one financial statement, provided the scope of the engagement was not limited. There are no requirements regarding the use of the balance sheet.

Choice "b" is incorrect. A review engagement may involve reporting on only one financial statement, provided the scope of the engagement was not limited. There is no requirement that the balance sheet be part of a comprehensive personal financial plan.

Choice "c" is incorrect. A review engagement may involve reporting on only one financial statement, provided the scope of the engagement was not limited. There is no requirement that accounting principles remain consistent during the year.

QUESTION NO: 7

The objective of a review of interim financial information of a public entity is to provide an accountant with a basis for reporting whether:

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

ANSWER: B

Explanation:

Choice "b" is correct. The objective of a review is to provide the accountant with a reasonable basis for expressing limited assurance that there are no material modifications that should be made to the accompanying financial statements for them to be in conformity with generally accepted accounting principles.

Choice "a" is incorrect. When performing a review, the accountant does not gather enough evidence to update an audit opinion.

Choice "c" is incorrect. There are no "standards of interim reporting."

Choice "d" is incorrect. Expressing an opinion as to whether the financial statements are presented fairly in accordance with GAAP is the result of an audit, not a review.

QUESTION NO: 8

The primary objective of procedures performed to obtain an understanding of the entity and its environment is to provide an auditor with:

- A. Knowledge necessary for risk assessment and audit planning.
- B. Audit evidence to use in assessing inherent risk.
- C. A basis for issuing an opinion on the financial statements.
- D. An evaluation of the consistency of application of management's policies.

ANSWER: A**Explanation:**

Choice "a" is correct. The auditor should obtain an understanding of the entity and its environment sufficient to assess the risk of material misstatement and to design and perform further audit procedures.

Choice "b" is incorrect. Assessing inherent risk is not the primary objective of obtaining an understanding of the entity and its environment.

Choice "c" is incorrect. Obtaining an understanding of the entity and its environment is not a sufficient basis for issuing an audit opinion.

Choice "d" is incorrect. Procedures performed to gain an understanding of the entity and its environment would not ordinarily test the consistency of the application of management's policies. If the auditor intends to rely on a control, its consistency in application would then be tested.

QUESTION NO: 9

Which of the following factors is (are) considered in determining the sample size for a test of controls?

	<i>Expected</i> <u>deviation rate</u>	<i>Tolerable</i> <u>deviation rate</u>
A.	Yes	Yes
B.	No	No
C.	No	Yes
D.	Yes	No

- A. Option A
- B. Option B
- C. Option C
- D. Option D

ANSWER: A

Explanation:

Choice "a" is correct. To determine the number of items to be selected for a particular sample for a test of controls, the auditor should consider the tolerable rate of deviation from the controls being tested, the likely rate of deviations (expected deviation rate), and the allowable risk of assessing control risk too low. Choices "b", "c", and "d" are incorrect, per the above

QUESTION NO: 10

An accountant performing a compilation or review of the financial statements of a nonissuer should:

- A. Be able to justify departures from SSARS.
- B. Never depart from SSARS guidelines.
- C. Exercise professional judgment in applying SSARS, since they are considered recommendations as opposed to standards.
- D. Not depart from Statements on Auditing Standards.

ANSWER: A

Explanation:

Choice "a" is correct. An accountant should be able to justify departures from SSARS.

Choice "b" is incorrect. An accountant may occasionally depart from SSARS guidelines, but should be prepared to justify such departures.

Choice "c" is incorrect. While it is true that an accountant should exercise professional judgment in applying SSARS, it is not true that SSARS are considered recommendations. SSARS are professional standards, which the accountant should generally follow.

Choice "d" is incorrect. Statements on Auditing Standards do not apply to compilations or reviews of the financial statements of a nonissuer.

QUESTION NO: 11

In performing an attest engagement, a CPA typically:

- A. Supplies litigation support services.

- B. Assesses control risk at a low level.
- C. Issues a report on subject matter (or on an assertion about subject matter) that is the responsibility of another party.
- D. Provides management consulting advice.

ANSWER: C

Explanation:

Choice "c" is correct. In performing an attest engagement, a CPA typically issues a report on subject matter (or on an assertion about subject matter) that is the responsibility of another party. Choice "a" is incorrect. Supplying litigation support services is not an attest engagement because the CPA is not reporting on subject matter (or an assertion about subject matter) that is the responsibility of another party.

Choice "b" is incorrect. An attest engagement may include a report on internal control; however, the assessed level of control risk may or may not be at a low level.

Choice "d" is incorrect. Management consulting advice is not considered to be an attest engagement because the CPA is not reporting on subject matter (or on an assertion about subject matter) that is the responsibility of another party.

QUESTION NO: 12

Which of the following is an inherent limitation in internal control?

- A. Incompatible duties.
- B. Lack of segregation of duties.
- C. Faulty human judgment.
- D. Lack of an audit committee.

ANSWER: C

Explanation:

Choice "c" is correct. Inherent limitations in internal control are limitations that exist despite implementation of appropriate controls. For example, faulty human judgment may result in errors in the design or use of internal controls.

Choice "a" is incorrect. Assigning incompatible duties to a particular individual indicates a missing control, rather than an inherent limitation in internal control.

Choice "b" is incorrect. Lack of segregation of duties indicates a missing control, rather than an inherent limitation in internal control. Choice "d" is incorrect. Lack of an audit committee indicates a missing control, rather than an inherent limitation in internal control.

QUESTION NO: 13

Financial information is presented in a printed form that prescribes the wording of the independent auditor's report. The form is not acceptable to the auditor because the form calls for statements that are inconsistent with the auditor's responsibility. Under these circumstances, the auditor most likely would:

- A. Withdraw from the engagement.
- B. Reword the form or attach a separate report.
- C. Express a qualified opinion with an

Explanation:

- D. Restrict use of the report to the party who designed the form.

ANSWER: B

Explanation:

- D. Restrict use of the report to the party who designed the form.

Answer: B

Choice "b" is correct. An auditor should not sign a preprinted report form that includes statements that are inconsistent with the auditor's responsibility. Instead, the form should be revised or a separate, more accurate report should be attached.

Choice "a" is incorrect. Provided the form can be revised or a separate report can be attached, there is no need to withdraw from the engagement.

Choice "c" is incorrect. Qualified opinions relate to departures from GAAP and/or scope limitations, neither of which is the case here.

Choice "d" is incorrect. Even if the use of the report is restricted, an auditor should never sign a report including statements that are inconsistent with the auditor's responsibility.

QUESTION NO: 14

A CPA is engaged to examine management's assertion that the entity's schedule of investment returns is presented in accordance with specific criteria. In performing this engagement, the CPA should comply with the provisions of:

- A. Statements on Standards for Accounting and Review Services (SSARS).
- B. Statements on Auditing Standards (SAS).
- C. Statements on Standards for Consulting Services (SSCS).
- D. Statements on Standards for Attestation Engagements (SSAE).

ANSWER: D

Explanation:

Choice "d" is correct. Statements on Standards for Attestation Engagements apply to engagements in which a practitioner is engaged to issue or does issue an examination, a review, or an agreed-upon procedures report on subject matter, or on an assertion about the subject matter, which is the responsibility of another party. An engagement to examine management's assertion that the entity's schedule of investment returns is presented in accordance with specific criteria would fall within this scope.

Choice "a" is incorrect. Statements on Standards for Accounting and Review Services apply to engagements involving the unaudited financial statements of a nonissuer. An engagement to examine management's assertion that the entity's schedule of investment returns is presented in accordance with specific criteria does not fall within this scope.

Choice "b" is incorrect. Statements on Auditing Standards apply to audits of financial statements. An engagement to examine management's assertion that the entity's schedule of investment returns is presented in accordance with specific criteria does not fall within this scope.

Choice "c" is incorrect. Statements on Standards for Consulting Services apply to a broad range of consulting services. An engagement to examine management's assertion that the entity's schedule of investment returns is presented in accordance with specific criteria is not a consulting service.

QUESTION NO: 15

Which of the following sampling methods would be used to estimate a numerical measurement of a population, such as a dollar value?

- A. Discovery sampling.
- B. Numerical sampling.
- C. Sampling for attributes.
- D. Sampling for variables.

ANSWER: D**Explanation:**

Choice "d" is correct. Variables sampling is used to estimate a numerical measurement of a population, such as the dollar value or the dollar value of errors in the population.

Choice "a" is incorrect. Discovery sampling is a special case of sampling for "attributes" (errors) where the auditor's initial estimate of error occurrence is zero or near zero. It does not sample for dollar value.

Choice "b" is incorrect. The term "numerical sampling" is not used in statistical sampling and is merely a well-designed distractor.

Choice "c" is incorrect. Attribute sampling is sampling for errors (or some other attribute). The auditor determines whether the attribute appears or not, but does not try to estimate a numerical measurement of the population.

QUESTION NO: 16

Which of the following would an auditor most likely use in determining the auditor's preliminary judgment about materiality?

- A. The results of the initial assessment of control risk.

- B. The anticipated sample size for planned substantive tests.
- C. The entity's financial statements of the prior year.
- D. The assertions that are embodied in the financial statements.

ANSWER: C

Explanation:

Choice "c" is correct. The auditor would most likely use the entity's financial statements of the prior year in the preliminary determination of materiality. The prior year financial statements would be a good starting point in estimating the current year's expected results, especially for a continuing client.

Choice "a" is incorrect. The assessment of control risk affects the design of audit procedures but is not relevant in determining materiality.

Choice "b" is incorrect. The anticipated sample size for planned substantive tests is set after the preliminary materiality level is determined. Choice "d" is incorrect. Management assertions embodied in the financial statements have little relationship to materiality.

QUESTION NO: 17

When an accountant performs more than one level of service (for example, a compilation and a review, or a compilation and an audit) concerning the financial statements of a nonissuer, the accountant generally should issue the report that is appropriate for:

- A. The lowest level of service rendered.
- B. The highest level of service rendered.
- C. A compilation engagement.
- D. A review engagement.

ANSWER: B

Explanation:

Choice "b" is correct. When an accountant performs more than one level of service (for example, a compilation and a review, or a compilation and an audit) concerning the financial statements of a nonissuer, the accountant generally should issue the report that is appropriate for the highest level of service rendered. Choices "a", "c", and "d" are incorrect. The report should be appropriate for the highest level of service rendered.

QUESTION NO: 18

At the conclusion of an audit, an auditor is reviewing the evidence gathered in support of the financial statements. With regard to the valuation of inventory, the auditor concludes that the evidence obtained is not sufficient to support management's representations. Which of the following actions is the auditor most likely to take?

- A. Consult with the audit committee and issue a disclaimer of opinion.
- B. Consult with the audit committee and issue a qualified opinion.
- C. Obtain additional evidence regarding the valuation of inventory.
- D. Obtain a statement from management supporting their inventory valuation.

ANSWER: C

Explanation:

Choice "c" is correct. If an auditor has doubts about a material assertion (such as the valuation of inventory), he/she should gather sufficient evidence to eliminate the doubt.

Choices "a" and "b" are incorrect. The auditor would not consult with the audit committee regarding the sufficiency of audit evidence obtained, as this is determined based on the auditor's own judgment. In addition, if the auditor is able to obtain additional evidence, it might be possible to issue an unqualified opinion. Finally, even if no additional evidence is available, the auditor will still need to decide whether a qualified opinion or a disclaimer of opinion is more appropriate, depending on materiality.

Choice "d" is incorrect. Since management representations are in fact "statements from management," obtaining additional statements from management would not provide additional support.

QUESTION NO: 19

Under properly designed internal control, the same employee most likely would match vendors' invoices with receiving reports and also:

- A. Post the detailed accounts payable records.
- B. Recompute the calculations on vendors' invoices.
- C. Reconcile the accounts payable ledger.
- D. Cancel vendors' invoices after payment.

ANSWER: B

Explanation:

Choice "b" is correct. Matching vendor's invoices with receiving reports provides authorization for payment and is generally performed in the accounts payable department. Recalculation of vendor invoices is compatible with this authorization function.

Choice "a" is incorrect. Posting the accounts payable records (recording) is incompatible with matching (authorization). Generally these functions would be performed by two different employees.

Choice "c" is incorrect. This review procedure (independent verification) should be performed by someone independent of the employee who approved the invoice for payment. Choice "d" is incorrect. Payment and cancellation of vendor invoices should be performed by someone (generally the treasurer) other than the individual authorizing payment.

QUESTION NO: 20

An auditor scans a client's investment records for the period just before and just after the year-end to determine that any transfers between categories of investments have been properly recorded. The primary purpose of this procedure is to obtain evidence about management's financial statement assertions of:

- A. Rights and obligations, and existence.
- B. Valuation and accuracy, and rights and obligations.
- C. Existence, and understandability and classification.
- D. Understandability and classification, and valuation and accuracy.

ANSWER: D**Explanation:**

Choice "d" is correct. Investments may be classified as trading, available-for-sale, or held-to-maturity. The classification of each investment into one of these three categories determines how it will be shown on the balance sheet (understandability and classification) and whether it will be valued at market or at amortized cost (valuation and accuracy).

Choices "a", "b", and "c" are incorrect. Reviewing transfers of investments between categories will not provide evidence regarding rights and obligations or existence. Rights and obligations and existence would be concerned with whether the securities actually exist and are owned by the client.