

4.7: End-of-Chapter Exercises

Questions

1. Why is it important that people and organizations have trust in the financial reporting process?
2. What is the Securities and Exchange Commission?
3. What types of companies fall under the jurisdiction of the SEC?
4. Who has the SEC given responsibility to for setting generally accepted accounting principles (GAAP) in the United States?
5. Who is the Emerging Issues Task Force?
6. Why doesn't the SEC examine all the financial statements submitted to it to ensure their accuracy?
7. For what must public companies hire an auditing firm before they submit their financial statements to the SEC?
8. Why would a nonpublic company have its statements audited?
9. What is a CPA?
10. Which organization sets standards for and regulates firms who audit public companies?
11. Which act established the Public Company Accounting Oversight Board?
12. Which organization sets standards for and regulates firms who do not audit public companies?
13. What type of assurance does an audit provide?
14. Why do audits not provide absolute assurance that financial statements are presented fairly according to GAAP?
15. What are internal controls?
16. How is an auditor's work affected by a company's internal controls?
17. What principles guide the implementation of an internal control system?
18. What are examples of internal control procedures?
19. To whom is the audit report addressed?
20. What is a clean opinion?
21. What is a critical audit matter?
22. Why would an auditor not give a clean opinion?

True or False

1. ____ The quality of a company's internal controls has no effect on the work of an auditor.
2. ____ Acquiring the CPA designation requires a candidate to pass an exam, meet education requirements, and meet experience requirements.
3. ____ The SEC is the current accounting standard setting body in the United States.
4. ____ The inclusion of an explanatory paragraph in an audit report is an indication that the financial statements should not be relied on.
5. ____ The PCAOB oversees auditors of public companies.
6. ____ Nonpublic companies have no reason to have an audit of their financial statements performed.
7. ____ If one manager approval is a good internal control then two approvals is always better.
8. ____ An individual who handles cash should not also be able to do the record keeping for cash.
9. ____ Audits are paid for by the creditors and investors of a company.
10. ____ CPAs can work for large, multinational firms, or for small, local firms.
11. ____ Auditors provide reasonable assurance that financial statements are fairly presented in accordance with U.S. GAAP.
12. ____ The Financial Accounting Standards Board is a governmental agency.

Multiple Choice

1. Whittington and Company is a CPA firm that audits publicly traded companies. Which of the following is true concerning Whittington and Company?
 1. Whittington and Company are regulated by FASB.
 2. Whittington and Company are hired by the companies they audit.
 3. Whittington and Company should follow the auditing standards set forth by the Auditing Standards Board.
 4. Whittington and Company prepares the financial statements for the companies they audit.
2. Which of the following is **not** true about an audit report?

1. An explanatory paragraph may be included to draw the reader's attention to some aspect of the financial statements.
 2. If a material misstatement exists in the financial statements and has not been corrected, the auditor should not issue a clean opinion.
 3. The report is addressed to the company's board of directors and shareholders.
 4. If anything other than clean opinion is issued, the financial statements must contain a material misstatement.
3. Which of the following is true about the Financial Accounting Standards Board (FASB)?
1. FASB sets standards that apply to companies throughout the world.
 2. FASB was created by the EITF to handle smaller issues in a timely manner.
 3. FASB produces standards that apply to almost all companies in the United States.
 4. FASB was created by the Securities Exchange Act of 1934.
4. Which organization is a governmental entity?
1. SEC
 2. FASB
 3. EITF
 4. ASB
5. Which of the following is true about the Securities and Exchange Commission (SEC)?
1. The SEC has the power to set accounting standards in the United States.
 2. The SEC does not have any enforcement powers.
 3. The SEC determines auditing standards for those who audit public companies.
 4. The SEC relies on fees collected from publicly traded companies to operate.
6. Which principle of internal control emphasizes the importance of someone or technology checking up to make sure that internal control procedures are being followed?
1. Monitoring
 2. Risk assessment
 3. Documentation
 4. Information and communication

Problems

1. Match the following organizations to their descriptions.
 - ____ FASB
 - ____ PCAOB
 - ____ SEC
 - ____ EITF
 - ____ ASB
 1. Sets auditing standards for auditors of publicly traded companies
 2. Sets U.S. generally accepted accounting principles
 3. Helps apply U.S. generally accepted accounting principles to new situations
 4. Sets auditing standards for auditors of private companies
 5. Created by the Securities Exchange Act of 1934 to protect investors
2. Read the case at <https://ethicsunwrapped.utexas.edu/video/tesco-cooks-the-books>

Answer the following questions:

- a. The officers of a public company owe a fiduciary duty, a duty of trust and confidence, to the company's shareholders. What was the fiduciary duty of Tesco? How did Tesco officers breach that duty? Why do you think Tesco did this? Explain.
- b. Do you think the officers were actually trying to fulfill their fiduciary duty to act in the shareholders' best interests, but doing so in a wrongful (and ultimately self-defeating) way? Why or why not?
- c. If the accounting irregularities had been an honest mistake, do you think Tesco would still be liable for breaking their fiduciary duty? Why or why not?

- d. As the shareholder of a public company, would you want your company's officers to fudge the numbers in order to avoid damage to the company's share price?
- e. If you were one of the accountants who faced pressure by managers to "pull forward" future income, what would you have done and why?

Research

1. The chapter mentions the Big Four public accounting firms: Deloitte, Ernst & Young, KPMG, and PricewaterhouseCoopers. We will visit the Web site for one of these—PricewaterhouseCoopers. Go to <http://www.pwc.com> and answer the following questions:
 1. Find two offices of PWC that are closest to your home - what are those offices according to the map in About Us.
 2. Select capabilities. Name four services that the firm offers in the United States besides financial statement audit.
 3. Select the Financial Statement Audit capability. What key points does the firm make about their financial statement audit process and what the PCAOB says about them?

PricewaterhouseCoopers is currently the auditor of Dell. Go to <http://www.dell.com> and scroll to "Our Company" at the bottom of the page. Choose "Investors" half way down the list. Click on "financials" in the upper ribbon. Choose SEC filings from the drop down menu. Choose 2023 and annual filings from the drop down menus below the graphic. Click on the icon for html to the right of the 10-k link. Find the auditors report (about page 74).

 4. What is the auditors opinion of the financial statements?
 5. Are there any critical audit matters? What were these matters? What did PWC do in response to these matters?
 6. What is the auditor's opinion on internal control included as part of the audit report (note references to opinions)?
2. In the United States, audits must be conducted by Certified Public Accountants (CPAs). Each state has different requirements that individuals must meet to become licensed as a CPA. This exercise will give you a chance to discover the rules in your state. Begin by going to the Web site for the National Association of State Boards of Accountancy (NASBA) at <http://www.nasba.org>. On the left the menu will show "Boards of Accountancy". Click on that item. A listing of the United States will appear. Click on your state. It will navigate to the information for your state. Click on the Web site given. By navigating around the Web site for your state board of accountancy, you should be able to find out what the exam, education, and experience requirements are in your state. Write these down.

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