



**3-25 (OBJECTIVES 3-4, 3-5, 3-6, 3-7, 3-8)** For the following independent situations, assume that you are the audit partner on the engagement:

1. A number of frozen yogurt stores have opened in the last few years and your client, YogurtLand, has experienced a noticeable decline in customer traffic over the past several months that has caused you to have substantial doubt about YogurtLand's ability to continue as a going concern.
2. Intelligis Electronics is a manufacturer of advanced electrical components. During the year, changes in the market resulted in a significant decrease in the demand for their products, which are now being sold significantly below cost. Management refuses to write-off the products or to increase the reserve for obsolescence.
3. In the last 3 months of the current year, Oil Refining Company decided to change direction and go significantly into the oil drilling business. Management recognizes that this business is exceptionally risky and could jeopardize the success of its existing refining business, but there are significant potential rewards. During the short period of operation in drilling, the company has had three dry wells and no successes. The facts are adequately disclosed in footnotes.
4. Your client, Harrison Automotive, has changed from straight-line to sum-of-the-years' digits depreciation. The effect on this year's income is immaterial, but the effect in future years may be highly material. The change is not disclosed in the footnotes.
5. Marseilles Fragrance, Inc., is based in New York but has operations throughout Europe. Because users of the audited financial statement are international, your audit firm was engaged to conduct the audit in accordance with U.S. auditing standards and International Standards on Auditing (ISAs).
6. Circumstances prevent you from being able to observe the counting of inventory at Brentwood Industries. The inventory amount is material in relation to Brentwood Industries' financial statements. But, you were able to perform alternative procedures to support the existence and valuation of the inventory at year-end.
7. Approximately 20% of the audit of Lumberton Farms, Inc., was performed by a different CPA firm, selected by you. You have reviewed their audit files and believe they did an excellent job on their portion of the audit. Nevertheless, you are unwilling to take complete responsibility for their work.

**Required** For each situation, do the following:

- a. Identify which of the conditions requiring a deviation from a standard unmodified opinion audit report is applicable, if any.
- b. State the level of materiality as immaterial, material, or highly material. If you cannot decide the level of materiality, state the additional information needed to make a decision.
- c. Given your answers in parts a. and b., state the appropriate audit report from the following alternatives (if you have not decided on one level of materiality in part b., state the appropriate report for each alternative materiality level):

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| (1) Unmodified opinion—standard wording           | (4) Qualified opinion only—GAAP departure |
| (2) Unmodified opinion—explanatory paragraph      | (5) Qualified opinion—scope limitation    |
| (3) Unmodified opinion—nonstandard report wording | (6) Disclaimer                            |
|   | (7) Adverse*                              |