MULTIPLE CHOICE QUESTIONS FROM CPA EXAMINATIONS

3-20 **(OBJECTIVES 3-1, 3-2, 3-3, 3-4, 3-8)** The following questions concern unmodified opinion audit reports. Choose the best response.

a. Which of the following is not a required element of a standard unmodified opinion audit report issued in accordance with AICPA auditing standards?
   (1) A title that emphasizes the report is from an independent auditor
   (2) The city and state of the audit firm issuing the report
   (3) A statement explaining management's responsibilities for the financial statements
   (4) The signature of the engagement partner

b. The date of the CPA's opinion on the financial statements of the client should be the date of the
   (1) completion of all important audit procedures.
   (2) closing of the client's books.
   (3) finalization of the terms of the audit engagement.
   (4) submission of the report to the client.

c. If a principal auditor decides to refer in his or her report to the audit of another auditor, he or she is required to disclose the
   (1) name of the other auditor.
   (2) nature of the inquiry into the other auditor's professional standing and extent of the review of the other auditor's work.
   (3) reasons for being unwilling to assume responsibility for the other auditor's work.
   (4) portion of the financial statements audited by the other auditor.

3-21 **(OBJECTIVES 3-4, 3-8)** The following questions concern unmodified opinion audit reports with an emphasis-of-matter explanatory paragraph or nonstandard wording in report paragraphs. Choose the best response.

a. An entity changed from the straight-line method to the declining-balance method of depreciation for all newly acquired assets. This change has no material effect on the current year's financial statements but is reasonably certain to have a substantial effect in later years. If the change is disclosed in the notes to the financial statements, the auditor should issue a report with a(n)
   (1) unmodified opinion.
   (2) qualified opinion.
   (3) unmodified opinion with explanatory paragraph.
   (4) qualified opinion with explanatory paragraph regarding consistency.

b. When the financial statements are fairly stated but the auditor concludes there is substantial doubt whether the client can continue in existence, the auditor should issue a(n)
   (1) adverse opinion.
   (2) qualified opinion only.
   (3) unmodified opinion.
   (4) unmodified opinion with explanatory paragraph.

c. The auditor's report contains the following: "We did not audit the financial statements of EZ, Inc., a wholly owned subsidiary, which statements reflect total assets and revenues constituting 27 percent and 29 percent, respectively, of the consolidated totals. Those statements were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for EZ, Inc., is based solely on the report of the other auditors." These sentences
   (1) assume responsibility for the other auditor.
   (2) indicate a division of responsibility.
   (3) require a departure from an unmodified opinion.
   (4) are an improper form of reporting.

3-24 (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. Auto Delivery Company has a fleet of several delivery trucks. In the past, Auto Delivery had followed the policy of purchasing all equipment. In the current year, they decided to lease the trucks. The method of accounting for the trucks is therefore changed to lease capitalization. This change in policy is fully disclosed in footnotes.
2. You are auditing Deep Clean Services for the first time. Deep Clean has been in business for several years but over the last two years has struggled to stay afloat given the economic conditions. Based on your audit work, you have substantial doubt that Deep Clean will be in business by the end of its next fiscal year.
3. One of your audit clients has a material investment in a privately held biosciences company. Your audit firm engaged a business valuation specialist to assist in evaluating the client's estimation of the investment's fair value. You conclude that the valuation specialist's work provides sufficient appropriate audit evidence.
4. Four weeks after the year-end date, a major customer of Prince Construction Co. declared bankruptcy. Because the customer had confirmed the balance due to Prince at the balance sheet date, management refuses to charge off the account or otherwise disclose the information. The receivable represents approximately 10% of accounts receivable and 20% of net earnings before taxes.
5. During your audit of Raceway.com, Inc., you conclude that there is a possibility that inventory is materially overstated. The client refuses to allow you to expand the scope of your audit sufficiently to verify whether the balance is actually misstated.
6. You complete the audit of Munich Department Store, and in your opinion, the financial statements are fairly presented. On the last day of the audit, you discover that one of your supervisors assigned to the audit has a material investment in Munich.

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 type of audit report that should be issued. If you have not decided on one level of materiality in part b., state the appropriate report for each alternative materiality level.

3-26 **(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. McClellan's Used Cars, a client of yours, recently changed its depreciation method from straight-line to sum-of-the-years' digits. The effect of the change on the current year's income is not material, but in future years, you suspect the effect will become material. The facts are adequately disclosed in footnotes.
2. Jordan Minerals recently decided to change its direction and spent the last 8 months developing business in the potash mining business. There are significant potential rewards, but the company's management recognizes that there are significant risks in the business that could jeopardize the success of its existing mining business. Since starting the new venture, the company has had no successes and some decline in profits. The facts are adequately disclosed in footnotes.
3. You recently noticed that Janssen Technology Solutions routinely excludes their statement of cash flows in the company's annual financial statements. Their reasoning, as explained to you, is that the statements are confusing to their readers, so they prefer to leave the information out.
4. A group of longtime friends decided to try their hand at online art auctions and online trade in antiquities. Although their venture started out well enough, a market-wide downturn in e-commerce sales abruptly plunged the start-up into the red. The future of the company looks bleak; both sales and cash position have declined substantially. If the market does not turn around soon, you think the company may not be able to continue to operate.
5. The controller of a company you're auditing will not allow you to confirm the receivable balances from any of its customers. However, the amounts of the receivables are material in relation to the company's financial statements. You cannot use any other methods to check the receivable balances.
6. Your firm has been unusually busy, so you asked another CPA firm to do about 30% of the audit for Abdoun's Arts, Inc. After a thorough review of their working papers, you are convinced that they did an excellent job on their portion of the audit. However, you are reluctant to take complete responsibility for their work.

Required

For each situation, do the following:

a. Identify which of the conditions requiring a modification of or a deviation from an unqualified report is applicable.

b. State the level of materiality as immaterial, material, or highly material. If you cannot decide the level of materiality from the given information, state the additional information that you would need to make a decision.

c. Given your answers to 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):

(i) Unqualified—standard wording
(ii) Unqualified—explanatory paragraph
(iii) Unqualified—modified wording
(iv) Qualified opinion only
(v) Qualified scope and opinion
(vi) Disclaimer
(vii) Adverse*

d. Based on your answer to part c, indicate which paragraphs, if any, should be modified in the standard audit report. Be sure to indicate whether an additional paragraph is necessary, if so, where it should be located in the report.