Question: 1

Several sources of GAAP consulted by an auditor are in conflict as to the application of an accounting principle. Which of the following should the auditor consider the most authoritative?

A. FASB Technical Bulletins.
B. AICPA Accounting Interpretations.
C. FASB Statements of Financial Accounting Concepts.
D. AICPA Technical Practice Aids.

Answer: A

Explanation: :
Choice "a" is correct. In accordance with the GAAP hierarchy, FASB Technical Bulletins are considered the most authoritative of the sources listed in the question.
Choice "b" is incorrect. Of the sources listed, AICPA Accounting Interpretations would be considered the second most authoritative.
Choice "c" is incorrect. FASB Statements of Financial Accounting Concepts are among the least authoritative sources of GAAP available to auditors.
Choice "d" is incorrect. AICPA Technical Practice Aids are among the least authoritative sources of GAAP available to auditors.

Question: 2

For an entity's financial statements to be presented fairly in conformity with generally accepted accounting principles, the principles selected should:

A. Be applied on a basis consistent with those followed in the prior year.
B. Be approved by the Auditing Standards Board or the appropriate industry subcommittee.
C. Reflect transactions in a manner that presents the financial statements within a range of acceptable limits.
D. Match the principles used by most other entities within the entity's particular industry.

Answer: C

Explanation:
Choice "c" is correct. Financial statements are presented fairly in conformity with GAAP when there are no material misstatements included therein. The fact that there may occasionally be immaterial misstatements means that the financial statements are correct "within a range of acceptable limits."
Choice "a" is incorrect. Accounting principles may change from year to year. As long as such changes are properly accounted for, the financial statements are still in conformity with GAAP.
Choice "b" is incorrect. The AICPA and the FASB determine GAAP, not the Auditing Standards Board.
Choice "d" is incorrect. There is no requirement that an entity's financial statements be prepared in accordance with prevalent industry practices in order to be in conformity with GAAP.

Question: 3

Which of the following statements is correct concerning an auditor's responsibilities regarding financial statements?

A. An auditor may not draft an entity's financial statements based on information from management's accounting system.
B. The adoption of sound accounting policies is an implicit part of an auditor's responsibilities.
C. An auditor's responsibilities for audited financial statements are confined to the expression of the auditor's opinion.
D. Making suggestions that are adopted about an entity's internal control environment impairs an auditor's independence.

Answer: C

Explanation:
Choice "c" is correct. An auditor's responsibility is to express an opinion on financial statements based on an audit.
Choice "a" is incorrect. An auditor may draft an entity's financial statements based on information from management's financial system. This would be referred to as a compilation engagement.
Choice "b" is incorrect. The adoption of sound accounting policies is an implicit part of management's responsibilities, not the auditor's responsibilities.
Choice "d" is incorrect. An auditor often makes suggestions that are adopted about an entity's internal control environment.
Professional Standards

Question: 4

Which of the following provides the most authoritative guidance for an auditor?

A. An AICPA audit and accounting guide that provides specific guidance with respect to the accounting practices in the client's industry.
B. A Journal of Accountancy article discussing implementation of a new standard.
C. General guidance provided by a Statement on Auditing Standards.
D. Specific guidance provided by an interpretation of a Statement on Auditing Standards.

Answer: C

Explanation:
Choice "c" is correct. General guidance provided by a Statement on Auditing Standards is the most authoritative of level of auditing guidance. Auditors are required to comply with SASs, and should be prepared to justify any departures therefrom.
Choices "a" and "d" are incorrect. AICPA audit and accounting guides and SAS interpretations are interpretive publications that provide guidance regarding how SASs should be applied in specific situations. They are not as authoritative as SASs.
Choice "b" is incorrect. Journal of Accountancy articles have no authoritative status but may be helpful to the auditor.

Question: 5

Which of the following accurately depicts the auditor's responsibility with respect to Statements on Auditing Standards?

A. The auditor is required to follow the guidance provided by the Standards, without exception.
B. The auditor is generally required to follow the guidance provided by Standards with which he or she is familiar, but will not be held responsible for departing from provisions of which he or she was unaware.
C. The auditor is generally required to follow the guidance provided by the Standards, unless following such guidance would result in an audit that is not cost-effective.

D. The auditor is generally required to follow the guidance provided by the Standards, and should be able to justify any departures.

Answer: D

Explanation:
Choice "d" is correct. The auditor is generally required to follow the guidance provided by the Standards, and should be able to justify any departures.
Choice "a" is incorrect. On rare occasions, the auditor may depart from the guidance provided by the SASs, but he or she must justify such departures.
Choice "b" is incorrect. Lack of familiarity with a SAS is not a valid reason for departing from its guidance.
The auditor is expected to have sufficient knowledge of the SASs to identify those that are applicable to a given audit engagement.
Choice "c" is incorrect. The cost associated with following the guidance provided by a SAS is not an acceptable reason for departing from its guidance.

Question: 6

In the first audit of a new client, an auditor was able to extend auditing procedures to gather sufficient evidence about consistency. Under these circumstances, the auditor should:

A. Not report on the client's income statement.
B. Not refer to consistency in the auditor's report.
C. State that the consistency standard does not apply.
D. State that the accounting principles have been applied consistently.

Answer: B

Explanation:
Choice "b" is correct. The auditor's standard report implies that the auditor is satisfied that the comparability of financial statements between periods has not been materially affected by changes in accounting principles and that such principles have been consistently applied between or among periods.
Since the auditor has gathered sufficient evidence about consistency, no reference need be made in the report.
Choice "a" is incorrect. If the auditor is able to obtain sufficient evidence about consistency, the auditor may report on the entity's financial statements.
Choice "c" is incorrect. The consistency standard is one of the ten GAAS, and it does apply to this audit.
Choice "d" is incorrect. If the auditor is able to obtain sufficient evidence about consistency, no mention of consistency need be made. Consistency is implied in the standard report.

Question: 7

The third general standard states that due care is to be exercised in the performance of an audit. This standard is ordinarily interpreted to require:

A. Thorough review of the existing safeguards over access to assets and records.
B. Limited review of the indications of employee fraud and illegal acts.
C. Objective review of the adequacy of the technical training and proficiency of firm personnel.
D. Critical review of the judgment exercised at every level of supervision.

Answer: D

Explanation:
Choice "d" is correct. The third general standard of due care is ordinarily interpreted to require critical review of the judgment exercised at every level of supervision, and the judgment exercised by those assisting in the audit.
Choice "a" is incorrect. The third general standard of due care does not require a thorough review of the existing safeguards over access to assets and records.
Choice "b" is incorrect. The standard of due care does not specifically require a limited review of the indications of employee fraud and illegal acts.
Choice "c" is incorrect. The standard of due care does not require a review of audit staff training and proficiency.

Question: 8

The concept of materiality would be least important to an auditor when considering the:

A. Adequacy of disclosure of a client's illegal act.
B. Discovery of weaknesses in a client's internal control.
C. Effects of a direct financial interest in the client on the CPA's independence.
D. Decision whether to use positive or negative confirmations of accounts receivable.

Answer: C

Explanation:
Choice "c" is correct. Any direct financial interest in a client impairs independence, even if it is immaterial.
Choice "a" is incorrect. A material illegal act may require disclosure in or adjustment to the financial statements, whereas an immaterial illegal act may not require disclosure.
Choice "b" is incorrect. A material weakness in internal control will affect the nature, timing, and extent of audit procedures, whereas an immaterial weakness in internal control may have little impact on the audit.
Choice "d" is incorrect. An auditor is likely to use positive confirmations for material accounts receivable, but may consider negative confirmations for immaterial receivable balances.

Question: 9

An auditor of a nonpublic company must conduct the audit in accordance with:
I. ASB standards.
II. PCAOB standards.

A. I.
B. Both I and II.
C. Either I or II, but not both.
D. II.

Answer: A

Explanation:
Choice "a" is correct. An auditor of a nonpublic company must conduct the audit in accordance with ASB standards.
Choice "b" is incorrect. An auditor of a nonpublic company is not required to conduct the audit in accordance with PCAOB standards.
Choice "c" is incorrect. While an auditor is only required to conduct the audit in accordance with ASB standards, the auditor may choose to follow PCAOB standards as well.
Choice "d" is incorrect. An auditor of a nonpublic company is not required to conduct the audit in accordance with PCAOB standards.

Question: 10

Because of the risk of material misstatement, an audit of financial statements in accordance with generally accepted auditing standards should be planned and performed with an attitude of:

A. Objective judgment.
B. Independent integrity.
C. Professional skepticism.
D. Impartial conservatism.

Answer: C

Explanation:
Choice "c" is correct. The auditor should plan and perform the audit with an attitude of professional skepticism. This attitude includes a questioning mind and a critical assessment of audit evidence.
Choices "a", "b", and "d" are incorrect. Objectivity, independence, integrity, and impartiality are basic ethical characteristics and professional qualities embodied in the general standards.

Question: 11

Which of the following is not an example of the application of professional skepticism?

A. Designing additional auditing procedures to obtain more reliable evidence in support of a particular financial statement assertion.
B. Obtaining corroboration of management's Explanation: s through consultation with a specialist.
C. Inquiring of prior year engagement personnel regarding their assessment of management's honesty and integrity.
D. Using third party confirmations to provide support for management's representations.

Answer: C

Explanation:
Choice "c" is correct. The auditor should consider that fraud might occur regardless of any past experience with the entity. An assessment of management's honesty and integrity performed during the previous year would not necessarily be relevant to the current year's audit.
Choice "a" is incorrect. An auditor might apply professional skepticism by performing additional audit procedures designed to improve the reliability of evidence.
Choice "b" is incorrect. Corroborating management's Explanation: s is an example of the application of professional skepticism, since the auditor is obtaining additional support rather than simply accepting the Explanation: as given.
Choice "d" is incorrect. Using third party confirmations to provide support for management's representations is an example of the application of professional skepticism, since the auditor is obtaining additional support rather than simply accepting the Explanation: as given.

Question: 12

Which of the following categories is included in generally accepted auditing standards?

A. Standards of review.
B. Standards of planning.
C. Standards of fieldwork.
D. Standards of evidence.

Answer: C

Explanation:
Choice "c" is correct. Generally accepted auditing standards include three categories: general standards, standards of fieldwork, and standards of reporting.
Choices "a", "b", and "d" are incorrect, based on the above Explanation: .
Reports on Audited Financial Statements

Question: 13

When qualifying an opinion because of an insufficiency of audit evidence, an auditor should refer to the situation in the:

	Scope paragraph	Notes to the financial statements
A.	Yes	Yes
B.	Yes	No
C.	No	Yes
D.	No	No

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

Answer: B

Explanation:
Choice "b" is correct. When a qualified opinion is issued due to a lack of sufficient audit evidence, the lack of evidence should be disclosed in an explanatory paragraph before the opinion paragraph. Since insufficient evidence is a scope limitation, the scope paragraph should also be modified to refer to the limitation and to the explanatory paragraph that discusses it.
Choices "a" and "c" are incorrect. Management (and not the auditor) prepares the notes to the financial statements. The auditor therefore would not refer to this (or any other) situation in the notes to the financial statements.
Choice "d" is incorrect. The auditor does refer to the situation in the scope paragraph.

Question: 14

When an auditor believes there is substantial doubt about the ability of an entity to continue as a going concern, all of the following should be included in the audit documentation, except:

A. The conditions that gave rise to the substantial doubt.
B. The auditor's conclusion about whether substantial doubt remains or is alleviated.
C. Management's conclusion regarding whether substantial doubt remains or is alleviated.
D. The effect of the auditor's conclusion on the auditor's report.

Answer: C

Explanation:

Choice "c" is correct. Whether substantial doubt remains or is alleviated is a judgment call made by the auditor, and there is no requirement to document management's opinion on the matter.
Choices "a", "b", and "d" are incorrect. When an auditor believes there is substantial doubt about the ability of an entity to continue as a going concern, the conditions that gave rise to the substantial doubt, the auditor's conclusion about whether substantial doubt remains or is alleviated, and the effect of the auditor's conclusion on the auditor's report should all be documented.

Question: 15

After considering an entity's negative trends and financial difficulties, an auditor has substantial doubt about the entity's ability to continue as a going concern. The auditor's considerations relating to management's plans for dealing with the adverse effects of these conditions most likely would include management's plans to:

A. Increase current dividend distributions.
B. Reduce existing lines of credit.
C. Increase ownership equity.
D. Purchase assets formerly leased.

Answer: C

Explanation:
Choice "c" is correct. The auditor considers any of management's plans that might serve to mitigate the adverse effects of particular conditions and events. Typically, plans to increase ownership equity, to borrow money, to restructure debt, to sell assets, and/or to reduce or delay expenditures might all be considered mitigating factors.
Choices "a", "b", and "d" are incorrect. Increasing dividend distributions, reducing lines of credit, and purchasing assets would not improve a weak cash flow situation.

Question: 16

In which of the following situations would an auditor ordinarily choose between expressing a qualified opinion or an adverse opinion?

A. The auditor did not observe the entity's physical inventory and is unable to become satisfied about its balance by other auditing procedures.
B. Conditions that cause the auditor to have substantial doubt about the entity's ability to continue as a going concern are inadequately disclosed.
C. There has been a change in accounting principles that has a material effect on the comparability of the entity's financial statements.
D. The auditor is unable to apply necessary procedures concerning an investor's share of an investee's earnings recognized on the equity method.

Answer: B

Explanation:
Choice "b" is correct. Inadequate disclosure of the substantial doubt about an entity's ability to continue as a going concern is a departure from GAAP, resulting in either a qualified or adverse opinion.
Choices "a" and "d" are incorrect. Scope limitations result in either a qualified opinion or in a disclaimer of opinion, but not in an adverse opinion.
Choice "c" is incorrect. A change in accounting principle results in a modified unqualified report, as long as the change was accounted for properly.

Question: 17

Which of the following conditions or events most likely would cause an auditor to have substantial doubt about an entity's ability to continue as a going concern?

A. Significant related party transactions are pervasive.
B. Usual trade credit from suppliers is denied.
C. Arrearages in preferred stock dividends are paid.
D. Restrictions on the disposal of principal assets are present.

Answer: B

Explanation:
Choice "b" is correct. Indications of possible financial difficulties, such as denial of usual trade credit from suppliers, may cause an auditor to have substantial doubt about an entity's ability to continue as a going concern.
Choice "a" is incorrect. The existence of related parties and the occurrence of related party transactions do not indicate doubt about the entity's ability to continue as a going concern.
Choice "c" is incorrect. Payment of preferred stock dividends in arrears might very well indicate an improvement in the entity's financial situation. It is the lack of payment of preferred, cumulative dividends (a possible indication of financial difficulty) that might cause an auditor to have substantial doubt about an entity's ability to continue as a going concern.
Choice "d" is incorrect. Restrictions on the disposal of assets might limit the options available to management as far as mitigating adverse conditions, but it would not in and of itself cause the auditor to have substantial doubt about an entity's ability to continue as a going concern.

Question: 18

In the first audit of a client, an auditor was not able to gather sufficient evidence about the consistent application of accounting principles between the current and prior year, as well as the amounts of assets or liabilities at the beginning of the current year. This was due to the client's record retention policies. If the amounts in question could materially affect current operating results, the auditor would:

A. Be unable to express an opinion on the current year's results of operations and cash flows.
B. Express a qualified opinion on the financial statements because of a client-imposed scope limitation.
C. Withdraw from the engagement and refuse to be associated with the financial statements.
D. Specifically state that the financial statements are not comparable to the prior year due to an uncertainty.

Answer: A

Explanation:
Choice "a" is correct. Since the auditor was unable to gather sufficient evidence on the beginning balances of the balance sheet accounts, the auditor would be unable to express an opinion on the current year's results of operations and cash flows. The auditor could express an opinion on the statement of financial position.
Choice "b" is incorrect. Since the scope limitation could have a pervasive effect on the financial statements (affecting all assets and liabilities), a disclaimer of opinion (and not merely a qualified opinion) is required on the income statement and statement of cash flows. An opinion may be expressed on the year-end statement of financial position.
Choice "c" is incorrect. The auditor does not need to withdraw from the engagement and refuse to be associated with the financial statements.
Choice "d" is incorrect. An uncertainty does not exist. The auditor can express an opinion on one of the financial statements.

Question: 19

Pell, CPA, decides to serve as principal auditor in the audit of the financial statements of Tech Consolidated, Inc. Smith, CPA, audits one of Tech's subsidiaries. In which situation(s) should Pell make reference to Smith's audit?
I. Pell reviews Smith's audit documentation and assumes responsibility for Smith's work, but expresses a qualified opinion on Tech's financial statements.
II. Pell is unable to review Smith's audit documentation; however, Pell's inquiries indicate that Smith has an excellent reputation for professional competence and integrity.

A. I only.
B. II only.
C. Both I and II.
D. Neither I nor II.

Answer: B

Explanation:
Choice "b" is correct. The principal auditor makes reference in the audit report to the work of the other auditor when the principal auditor is unable to review the other auditor's audit documentation. This is because the principal auditor will be unable to be satisfied concerning the work performed by the other auditor. Even though the other auditor has an excellent reputation, the principal auditor must see the work to be able to assume responsibility for it.
Choice "a" is incorrect. When the principal auditor decides to assume responsibility for the work of the other independent auditor, no reference is made to the work of the other auditor, regardless of the type of audit report expressed.
Choice "c" is incorrect. When the principal auditor decides to assume responsibility for the work of the other independent auditor, no reference is made to the work of the other auditor, regardless of the type of audit report expressed.
Choice "d" is incorrect. The principal auditor will make reference in the audit report to the work of the other auditor when the principal auditor is unable to review the other auditor's audit documentation. This is because the principal auditor will be unable to be satisfied concerning the work performed by the other auditor. Even though the other auditor has an excellent reputation, the principal auditor must see the work to be able to assume responsibility for it.

Question: 20

Cooper, CPA, believes there is substantial doubt about the ability of Zero Corp. to continue as a going concern for a reasonable period of time. In evaluating Zero's plans for dealing with the adverse effects of future conditions and events, Cooper most likely would consider, as a mitigating factor, Zero's plans to:

A. Discuss with lenders the terms of all debt and loan agreements.
B. Strengthen internal controls over cash disbursements.
C. Purchase production facilities currently being leased from a related party.
D. Postpone expenditures for research and development projects.

Answer: B

Explanation:
Choice "d" is correct. When assessing management's plans for dealing with the adverse effects of future conditions and events, mitigating factors would include:
1. The postponement of expenditures (including R&D)

2. Plans to dispose of assets,
3. Plans to borrow money or restructure debt,
4. Plans to increase ownership equity (sell stock).
Choice "a" is incorrect. Discussions with lenders regarding terms would not be a mitigating factor. Actual agreements regarding restructuring of debt or amendments to covenants would be required.
Choice "b" is incorrect. Strengthening internal controls over cash would not qualify as a management tactic to address going concern issues.
Choice "c" is incorrect. Purchasing facilities which are currently being leased would only further decrease cash flow.

Question: 21

Which of the following statements is a basic element of the auditor's standard report?

A. The disclosures provide reasonable assurance that the financial statements are free of material misstatement.
B. The auditor evaluated the overall internal control.
C. An audit includes assessing significant estimates made by management.
D. The financial statements are consistent with those of the prior period.

Answer: C

Explanation:
Choice "c" is correct. The auditor's standard audit report includes a statement that "An audit includes assessing...significant estimates made by management..."
Choice "a" is incorrect. The standard audit report does not state that disclosures provide reasonable assurance that the financial statements are free of material misstatement. The correct statement is:
"...standards require that we plan and perform the audit to obtain reasonable assurance that the financial statements are free of material misstatement."
Choice "b" is incorrect. The standard audit report does not state that the auditor evaluated the overall internal control. The correct statement is "An audit includes...evaluating the overall financial statement presentation." Internal control is not mentioned in the standard audit report.
Choice "d" is incorrect. The standard audit report does not state "The financial statements are consistent with those of the prior period." According to the second standard of reporting, consistency is implicitly reported. Only if there is an inconsistency is an explicit statement included.

Question: 22

An auditor may not issue a qualified opinion when:

A. An accounting principle at variance with GAAP is used.
B. The auditor lacks independence with respect to the audited entity.
C. A scope limitation prevents the auditor from completing an important audit procedure.
D. The auditor's report refers to the work of a specialist.

Answer: B

Explanation:
Choice "b" is correct. If the auditor lacks independence with respect to an audit client, the auditor must disclaim an opinion on the financial statements. A qualified opinion is not an option.
Choice "a" is incorrect. A departure from GAAP (which is not sufficiently material to warrant an adverse opinion) may justify a qualification of the auditor's report.
Choice "c" is incorrect. A scope limitation may result in a qualified opinion or a disclaimer of opinion.

Choice "d" is incorrect. The auditor's report may make reference to the use of a specialist only if the specialist's findings result in a change to the auditor's report, such as a qualified opinion.

Question: 23

An auditor most likely would express an unqualified opinion and would not add explanatory language to the report if the auditor:

A. Wishes to emphasize that the entity had significant transactions with related parties.
B. Concurs with the entity's change in its method of computing depreciation.
C. Discovers that supplementary information required by FASB has been omitted.
D. Believes that there is a probable likelihood of a material loss resulting from an uncertainty that is sufficiently supported and disclosed.

Answer: D

Explanation:
Choice "d" is correct. An auditor most likely would express an unqualified opinion and would not add explanatory language to the report if the auditor believes that there is a probable likelihood of a material loss resulting from an uncertainty that is sufficiently supported and disclosed.
Choice "a" is incorrect. Emphasis of a matter, such as the existence of significant transactions with related parties, may result in an additional explanatory paragraph appended to an otherwise unqualified opinion.
Choice "b" is incorrect. A change in accounting principle does result in an additional explanatory paragraph appended to an otherwise unqualified opinion.
Choice "c" is incorrect. Omission of supplemental information required by GAAP does result in an additional explanatory paragraph appended to an otherwise unqualified opinion.

Question: 24

An auditor would express an unqualified opinion with an explanatory paragraph added to the auditor's report for:

	An unjustified accounting change	*A material weakness in internal control*
A.	Yes	Yes
B.	Yes	No
C.	No	Yes
D.	No	No

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

Answer: D

Explanation:
Choice "d" is correct. An unjustified accounting change may cause the auditor to issue a qualified or adverse opinion. A material weakness must be reported to management and those charged with governance, but would not be disclosed in an explanatory paragraph appended to an otherwise unqualified opinion.
Choices "a", "b", and "c" are incorrect, as per the above Explanation: .

Question: 25

Digit Co. uses the FIFO method of costing for its international subsidiary's inventory and LIFO for its domestic inventory. Under these circumstances, the auditor's report on Digit's financial statements should express an:

A. Unqualified opinion.
B. Opinion qualified because of a lack of consistency.
C. Opinion qualified because of a departure from GAAP.
D. Adverse opinion.

Answer: A

Explanation:
Choice "a" is correct. GAAP allows a company to use different methods for costing different inventories as long as the methods are disclosed. Thus, the audit report would be unqualified; there is no departure from GAAP.
Choice "b" is incorrect. The consistency standard refers to changes in application of accounting practices between periods, affecting the comparability of financial statements. There is no indication Digit made any change in methods.
Choice "c" is incorrect. Use of different methods for costing inventory is permissible under GAAP, and would not result in a qualification of the auditor's report.
Choice "d" is incorrect. Use of different methods for costing inventory is permissible under GAAP, and would not result in an adverse report.

Question: 26

In which of the following circumstances would an auditor not express an unqualified opinion?

A. There has been a material change between periods in accounting principles.
B. Quarterly financial data required by the SEC has been omitted.
C. The auditor wishes to emphasize an unusually important subsequent event.
D. The auditor is unable to obtain audited financial statements of a consolidated investee.

Answer: D

Explanation:
Choice "d" is correct. The inability to obtain audited financial statements of a consolidated investee represents a scope limitation which may result in either a qualified opinion or a disclaimer of opinion.
Choice "a" is incorrect. A material change in accounting principles between periods is disclosed in an explanatory paragraph added to an otherwise unqualified opinion.
Choice "b" is incorrect. Omission of selected quarterly data required by SEC regulations is disclosed in an explanatory paragraph added to an otherwise unqualified opinion.
Choice "c" is incorrect. Emphasis of a matter is disclosed in an explanatory paragraph added to an otherwise unqualified opinion.

Question: 27

Management of Edgington Industries plans to disclose an uncertainty as follows:
The Company is a defendant in a lawsuit alleging infringement of certain patent rights and claiming damages. Discovery proceedings are in progress. The ultimate outcome of the litigation cannot presently be determined.

Accordingly, no provision for any liability that may result upon adjudication has been made in the accompanying financial statements.
The auditor is satisfied that sufficient audit evidence supports management's assertions about the nature and disclosure of the uncertainty. What type of opinion should the auditor express under these circumstances?

A. Unqualified without an explanatory paragraph.
B. "Subject to" qualified.
C. "Except for" qualified.
D. Disclaimer of opinion.

Answer: A

Explanation:
Choice "a" is correct. The note presented describes an uncertainty that is properly discloseD. An explanatory paragraph is not required in the unqualified opinion.
Choice "b" is incorrect. A "subject to" qualified opinion should never be issued.
Choice "c" is incorrect. Since the auditor is satisfied that the assertion and disclosure are supported by the existing evidence, a qualified opinion is not required.
Choice "d" is incorrect. Since the auditor is satisfied that the assertion and disclosure are supported by the existing evidence, there is no need for the auditor to disclaim an opinion.

Question: 28

Kane, CPA, concludes that there is substantial doubt about Lima Co.'s ability to continue as a going concern for a reasonable period of time. If Lima's financial statements adequately disclose its financial difficulties, Kane's auditor's report is required to include an explanatory paragraph that specifically uses the phrase(s):

	"Possible discontinuance of operations"	*"Reasonable period of time, not to exceed one year"*
A.	Yes	Yes
B.	Yes	No
C.	No	Yes
D.	No	No

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

Answer: D

Explanation:
Choice "d" is correct. If, after considering identified conditions and events and management's plans, the auditor concludes that substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time remains, the audit report should include an explanatory paragraph (following the opinion paragraph) to reflect that conclusion. This conclusion should be expressed through the use of the phrase "substantial doubt about its (the entity's) ability to continue as a going concern" [or similar wording that includes the terms "substantial doubt" and "going concern"]. The "reasonable period...not to exceed one year" is inherent in the definition of going concern and is not explicitly stated in the audit report. The phrase "possible discontinuation of operations" may be included in the going concern disclosure but is not specifically required.
Choices "a", "b", and "c" are incorrect, as per the above Explanation: .

Question: 29

Mead, CPA, had substantial doubt about Tech Co.'s ability to continue as a going concern when reporting on Tech's audited financial statements for the year ended June 30, 19X4. That doubt has been removed in 19X5. What is Mead's reporting responsibility if Tech is presenting its financial statements for the year ended June 30, 19X5, on a comparative basis with those of 19X4?

A. The explanatory paragraph included in the 19X4 auditor's report should not be repeated.
B. The explanatory paragraph included in the 19X4 auditor's report should be repeated in its entirety.
C. A different explanatory paragraph describing Mead's reasons for the removal of doubt should be included.
D. A different explanatory paragraph describing Tech's plans for financial recovery should be included.

Answer: A

Explanation:
Choice "a" is correct. If substantial doubt about the entity's ability to continue as a going concern has been removed in the current period, the explanatory paragraph included in the prior period auditor's report should not be repeated, and no description of the reasons or plans for recovery need be included.
Choice "b" is incorrect. If doubt about the going concern assumption has been removed in the current period, it is not appropriate to include the explanatory paragraph from the prior year in the auditor's report for the current year.
Choice "c" is incorrect. If doubt about the going concern assumption has been removed in the current period, no explanatory paragraph is required since the situation no longer exists. The auditor does not have to explain the reason for the change.
Choice "d" is incorrect. If doubt about the going concern assumption has been removed in the current period, no explanatory paragraph is required since the situation no longer exists. The entity does not have to describe its plans for the future.

Question: 30

March, CPA, is engaged by Monday Corp., a client, to audit the financial statements of Wall Corp., a company that is not March's client. Monday expects to present Wall's audited financial statements with March's auditor's report to 1st Federal Bank to obtain financing in Monday's attempt to purchase Wall. In these circumstances, March's auditor's report would usually be addressed to:

A. Monday Corp., the client that engaged March.
B. Wall Corp., the entity audited by March.
C. 1st Federal Bank.
D. Both Monday Corp. and 1st Federal Bank.

Answer: A

Explanation:
Choice "a" is correct. The auditors should address their report to the entity that engaged them. In this case, Monday Corp. engaged the auditor to perform an acquisition audit and the report should be addressed to Monday.
Choice "b" is incorrect. Wall Corp. did not engage the auditors and thus the report should not be addressed to them.
Choices "c" and "d" are incorrect. Even though the bank will be relying on the audited financial statements in determining whether to make the loan, the bank did not directly engage the auditing firm and accordingly, the report should not be addressed to them.

Question: 31

An auditor issued an audit report that was dual dated for a subsequent event occurring after the original date of the auditor's report but before issuance of the related financial statements. The auditor's responsibility for events occurring subsequent to the original report date was:

A. Limited to include only events occurring up to the date of the last subsequent event referenced.
B. Limited to the specific event referenced.
C. Extended to subsequent events occurring through the later date.
D. Extended to include all events occurring since the original report date.

Answer: B

Explanation:
Choice "b" is correct. When an auditor issues a report that is dual dated for a subsequent event occurring after the original date of the auditor's report, but before issuance of the related financial statements, the auditor's responsibility for events occurring subsequent to the original report date is limited to the specific event referenced.
Choices "a", "c", and "d" are incorrect. The auditor takes responsibility for only the specific event noted in the dual dating and no other event occurring subsequent to the original report date.

Question: 32

When an independent CPA is associated with the financial statements of a publicly held entity but has not audited or reviewed such statements, the appropriate form of report to be issued must include a(an):

A. Regulation S-X exemption.
B. Report on pro forma financial statements.
C. Unaudited association report.
D. Disclaimer of opinion.

Answer: D

Explanation:
Choice "d" is correct. When an accountant is associated with the financial statements of a public entity, but has not audited or reviewed such statements, the accountant must issue a report disclaiming any opinion on the statements.
Choices "a", "b", and "c" are incorrect since a disclaimer is required in this case.

Question: 33

Which of the following auditing procedures most likely would assist an auditor in identifying conditions and events that may indicate substantial doubt about an entity's ability to continue as a going concern?

A. Inspecting title documents to verify whether any assets are pledged as collateral.
B. Confirming with third parties the details of arrangements to maintain financial support.
C. Reconciling the cash balance per books with the cut-off bank statement and the bank confirmation.
D. Comparing the entity's depreciation and asset capitalization policies to other entities in the industry.

Answer: B

Explanation:

Choice "b" is correct. Confirming with third parties the details of arrangements to provide or "maintain (needed) financial support" is an audit procedure that may identify doubts about an entity's ability to continue as a going concern.
Choice "a" is incorrect. Inspecting title documents provides evidence of ownership of assets but would not necessarily identify conditions affecting an entity's ability to continue as a going concern.
Choice "c" is incorrect. Reconciling the cash balance per books with the cut-off bank statement and the bank confirmation provides evidence of completeness and valuation, but would not necessarily identify conditions affecting an entity's ability to continue as a going concern.
Choice "d" is incorrect. Comparing an entity's policies to other entities in the industry would not necessarily identify conditions affecting an entity's ability to continue as a going concern.

Question: 34

When an independent CPA assists in preparing the financial statements of a publicly held entity, but has not audited or reviewed them, the CPA should issue a disclaimer of opinion. In such situations, the CPA has no responsibility to apply any procedures beyond:

A. Documenting that internal control is not being relied on.
B. Reading the financial statements for obvious material misstatements.
C. Ascertaining whether the financial statements are in conformity with GAAP.
D. Determining whether management has elected to omit substantially all required disclosures.

Answer: B

Explanation:
Choice "b" is correct. The accountant is only required to read the financial statements for obvious material misstatements.
Choice "a" is incorrect. The accountant need not document that internal control is not being relied on.
Choices "c" and "d" are incorrect. The accountant is not required to evaluate conformity with GAAP, but any known departures (including inadequate disclosure) should be described in the disclaimer.

Question: 35

When an auditor concludes there is substantial doubt about a continuing audit client's ability to continue as a going concern for a reasonable period of time, the auditor's responsibility is to:

A. Issue a qualified or adverse opinion, depending upon materiality, due to the possible effects on the financial statements.
B. Consider the adequacy of disclosure about the client's possible inability to continue as a going concern.
C. Report to the client's audit committee that management's accounting estimates may need to be adjusted.
D. Reissue the prior year's auditor's report and add an explanatory paragraph that specifically refers to "substantial doubt" and "going concern."

Answer: B

Explanation:
Choice "b" is correct. When an auditor concludes there is substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time, the auditor's responsibility is to consider the adequacy of disclosure about the entity's possible inability to continue as a going concern and include an explanatory paragraph in the audit report.

Choice "a" is incorrect. The auditor would include an explanatory paragraph following the unqualified opinion, or disclaim an opinion due to a material uncertainty. A qualified or adverse opinion is not appropriate for doubt about an entity's ability to continue as a going concern.
Choice "c" is incorrect. Management's accounting estimates are unrelated to going concern issues.
Choice "d" is incorrect. Going concern issues are considered prospectively. It is not appropriate to reissue a prior audit report if doubt arises about an entity's ability to continue in a future period.

Question: 36

Reference in a principal auditor's report to the fact that part of the audit was performed by another auditor most likely would be an indication of the:

A. Divided responsibility between the auditors who conducted the audits of the components of the overall financial statements.
B. Lack of materiality of the portion of the financial statements audited by the other auditor.
C. Principal auditor's recognition of the other auditor's competence, reputation, and professional certification.
D. Different opinions the auditors are expressing on the components of the financial statements that each audited.

Answer: A

Explanation:
Choice "a" is correct. Reference to another auditor indicates division of responsibility for the audits of the components of the overall financial statements.
Choice "b" is incorrect. Reference to another auditor would not generally be made if the other auditor's portion of the financial statements were immaterial.
Choice "c" is incorrect. The reference in the report is not meant to recognize the qualifications of the other auditor, but simply to divide the responsibility between the two auditors.
Choice "d" is incorrect. The reference to the other auditor would be made regardless of what type of opinion is expressed by each auditor.

Question: 37

An auditor includes a separate paragraph in an otherwise unmodified report to emphasize that the entity being reported on had significant transactions with related parties. The inclusion of this separate paragraph:

A. Is considered an "except for" qualification of the opinion.
B. Violates generally accepted auditing standards if this information is already disclosed in footnotes to the financial statements.
C. Necessitates a revision of the opinion paragraph to include the phrase "with the foregoing Explanation: ."
D. Is appropriate and would not negate the unqualified opinion.

Answer: D

Explanation:
Choice "d" is correct. Emphasis of a matter should be disclosed in an explanatory paragraph appended to an otherwise unqualified opinion.
Choice "a" is incorrect. An "except for" qualification is used for a scope limitation or a departure from GAAP, but not for emphasis of a matter.
Choice "b" is incorrect. The auditor may emphasize a matter even if it is included in the footnotes.
Choice "c" is incorrect. A phrase such as "with the foregoing Explanation: " should not be used in an unqualified opinion.

Question: 38

When there has been a change in accounting principles, but the effect of the change on the comparability of the financial statements is not material, the auditor should:

A. Refer to the change in an explanatory paragraph.
B. Explicitly concur that the change is preferred.
C. Not refer to consistency in the auditor's report.
D. Refer to the change in the opinion paragraph.

Answer: C

Explanation:
Choice "c" is correct. If an accounting change has no material effect on the comparability of the financial statements, the auditor does not need to recognize the change in the current year's audit report.
Choice "a" is incorrect. The change would only be referred to in an explanatory paragraph if the effect were material.
Choice "b" is incorrect. The auditor does not explicitly concur with the change in the report.
Choice "d" is incorrect. Even if the change had a material effect, the opinion paragraph would not be affected. The explanatory paragraph would follow the opinion paragraph.

Question: 39

When single-year financial statements are presented, an auditor ordinarily would express an unqualified opinion in an unmodified report if the:

A. Auditor is unable to obtain audited financial statements supporting the entity's investment in a foreign affiliate.
B. Entity declines to present a statement of cash flows with its balance sheet and related statements of income and retained earnings.
C. Auditor wishes to emphasize an accounting matter affecting the comparability of the financial statements with those of the prior year.
D. Prior year's financial statements were audited by another CPA whose report, which expressed an unqualified opinion, is not presented.

Answer: D

Explanation:
Choice "d" is correct. Since only single-year financial statements are presented, the fact that another CPA audited the prior year's financial statements is not relevant. Therefore, the auditor would express an unqualified opinion in an unmodified report.
Choice "a" is incorrect. The situation described would result in a qualified opinion or disclaimer of opinion due to a scope limitation.
Choice "b" is incorrect. The situation described would result in an qualified opinion due to inadequate disclosure.
Choice "c" is incorrect. The situation described would result in an otherwise unqualified opinion modified by adding an additional explanatory paragraph after the opinion paragraph.

Question: 40

Park, CPA, was engaged to audit the financial statements of Tech Co., a new client, for the year ended December 31, 20X3. Park obtained sufficient audit evidence for all of Tech's financial statement items except Tech's opening inventory. Due to inadequate financial records, Park could not verify Tech's January 1, 20X3, inventory balances. Park's opinion on Tech's 20X3 financial statements most likely will be:

Balance sheet	Income statement
A. Disclaimer	Disclaimer
B. Unqualified	Disclaimer
C. Disclaimer	Adverse
D. Unqualified	Adverse

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

Answer: B

Explanation:
Choice "b" is correct. When the auditor is unable to satisfy himself or herself regarding the amount of beginning inventory, he or she must disclaim an opinion on the income statement because of the inability to verify the cost of goods sold during the year. The auditor may, however, still be able to issue an unqualified opinion on the balance sheet, since inventory can be verified as of the balance sheet date.
Choices "a", "c", and "d" are incorrect, based on the Explanation: above.