

Auditing and Assurance Services, 14e (Arens)

Chapter 3 Audit Reports

Learning Objective 3-1

1) An audit of historical financial statements most commonly includes the:

- A) balance sheet, statement of retained earnings, and the statement of cash flows.
- B) income statement, the statement of cash flows, and the statement of net working capital.
- C) statement of cash flows, balance sheet, and the statement of retained earnings.
- D) balance sheet, income statement, and the statement of cash flows.

Answer: D

Terms: Audit of historical financial statements

Diff: Moderate

Objective: LO 3-1

AACSB: Reflective thinking skills

2) Auditing standards require that the audit report must be titled and that the title must:

- A) include the word "independent."
- B) indicate if the auditor is a CPA.
- C) indicate if the auditor is a proprietorship, partnership, or incorporated.
- D) indicate the type of audit opinion issued.

Answer: A

Terms: Auditing standards require audit report title

Diff: Easy

Objective: LO 3-1

AACSB: Reflective thinking skills

3) To emphasize the fact that the auditor is independent, a typical addressee of the audit report could be:

A)

Company Controller	Shareholders	Board of Directors
No	Yes	Yes

B)

Company Controller	Shareholders	Board of Directors
No	No	Yes

C)

Company Controller	Shareholders	Board of Directors
Yes	Yes	No

D)

Company Controller	Shareholders	Board of Directors
Yes	No	No

Answer: A

Terms: Audit report addressee

Diff: Easy

Objective: LO 3-1

AACSB: Reflective thinking skills

4) The scope paragraph of the standard unqualified audit report states that the audit is designed to:

A) discover all errors and/or irregularities.

B) discover material errors and/or irregularities.

C) conform to generally accepted accounting principles.

D) obtain reasonable assurance whether the statements are free of material misstatement.

Answer: D

Terms: Scope paragraph of standard unqualified audit report states

Diff: Easy

Objective: LO 3-1

AACSB: Reflective thinking skills

5) The audit report date on a standard unqualified report indicates:

A) the last day of the fiscal period.

B) the date on which the financial statements were filed with the Securities and Exchange Commission.

C) the last date on which users may institute a lawsuit against either client or auditor.

D) the last day of the auditor's responsibility for the review of significant events that occurred subsequent to the date of the financial statements.

Answer: D

Terms: Audit report date on standard unqualified report

Diff: Easy

Objective: LO 3-1

AACSB: Reflective thinking skills

6) The standard audit report refers to GAAS and GAAP in which paragraphs?

A)

GAAS	GAAP
Scope only	Opinion only

B)

GAAS	GAAP
Intro only	Scope and Opinion

C)

GAAS	GAAP
Intro and Scope	Opinion only

D)

GAAS	GAAP
Intro only	All paragraphs

Answer: A

Terms: Standard audit report; GAAS and GAAP

Diff: Easy

Objective: LO 3-1

AACSB: Reflective thinking skills

7) Which of the following is not explicitly stated in the standard unqualified audit report?

- A) The financial statements are the responsibility of management.
- B) The audit was conducted in accordance with generally accepted accounting principles.
- C) The auditors believe that the audit provides a reasonable basis for their opinion.
- D) An audit includes assessing the accounting estimates used.

Answer: B

Terms: Standard unqualified audit report

Diff: Easy

Objective: LO 3-1

AACSB: Reflective thinking skills

8) If an auditor performs an audit of a public company, the scope paragraph should make reference to which standards?

- A) GAAP.
- B) GAAS.
- C) Standards issued by the PCAOB (U.S.).
- D) International Audit Standards.

Answer: C

Terms: Audit of public company, scope paragraph

Diff: Easy

Objective: LO 3-1

AACSB: Reflective thinking skills

Topic: Public

9) The introductory paragraph of the standard audit report states that the financial statements are:

- A) the responsibility of the auditor.
- B) the responsibility of management.
- C) the joint responsibility of management and the auditor.
- D) none of the above.

Answer: B

Terms: Introductory paragraph of standard audit report

Diff: Moderate

Objective: LO 3-1

AACSB: Reflective thinking skills

10) The introductory paragraph of the standard audit report performs which functions?

- I. State the CPA has performed an audit.
- II. Lists the financials being audited.
- III. States the financials are the responsibility of the auditor.

- A) I and II
- B) I and III
- C) II and III
- D) I, II and III

Answer: C

Terms: Introductory paragraph of standard audit report

Diff: Moderate

Objective: LO 3-1

AACSB: Reflective thinking skills

11) Which of the following statements are true?

- I. The introductory paragraph states that management is responsible for the preparation and content of the financial statements.
- II. The scope paragraph states that the auditor evaluates the appropriateness of those accounting principles, estimates, and financial statement disclosures.

- A) I only
- B) II only
- C) I and II
- D) Neither I nor II

Answer: C

Terms: Introductory paragraph and scope paragraph

Diff: Moderate

Objective: LO 3-1

AACSB: Reflective thinking skills

12) The introductory paragraph of the standard audit report states that the auditor is:

- A) responsible for the financial statements and the opinion on them.
- B) responsible for the financial statements.
- C) responsible for the opinion on the financial statements.
- D) jointly responsible for the financial statements with management.

Answer: C

Terms: Introductory paragraph of standard audit report

Diff: Moderate

Objective: LO 3-1

AACSB: Reflective thinking skills

13) If the balance sheet of a company is dated December 31, 2011, the audit report is dated February 8, 2012, and both are released on February 15, 2012, this indicates that the auditor has searched for subsequent events that occurred up to:

- A) December 31, 2011.
- B) January 1, 2012.
- C) February 8, 2012.
- D) February 15, 2012.

Answer: C

Terms: Audit report subsequent event dating

Diff: Moderate

Objective: LO 3-1

AACSB: Reflective thinking skills

14) Which of the following is true concerning financial statements issued by a U.S. entity to the Securities and Exchange Commission?

- A) Financial statements can be prepared using International Financial Reporting Standards.
- B) The United States now allows an auditor to perform an audit of financial statements of a U.S. entity in accordance with both GAAS and International Audit Standards.
- C) The United States only allows an auditor to perform an audit of financial statement of an entity in accordance with GAAS if they are using International Financial Reporting Standards.
- D) An audit that uses both the GAAS and International Audit standards must modify the scope paragraph to include both sets of standards.

Answer: C

Terms: Financial statements issued by U.S. entity to Securities and Exchange Commission

Diff: Challenging

Objective: LO 3-1

AACSB: Reflective thinking skills

15) Most auditors believe that financial statements are "presented fairly" when the statements are in accordance with GAAP, and that it is also necessary to:

- A) determine that they are not in violation of FASB statements.
- B) examine the substance of transactions and balances for possible misinformation.
- C) review the statements using the accounting principles promulgated by the SEC.
- D) assure investors that net income reported this year will be exceeded in the future.

Answer: B

Terms: Financial statements are presented fairly in accordance with GAAP

Diff: Challenging

Objective: LO 3-1

AACSB: Reflective thinking skills

- 16) In which of the following situations would the auditor most likely issue an unqualified report?
- A) The client valued ending inventory by using the replacement cost method.
 - B) The client valued ending inventory by using the Next-In-First-Out (NIFO) method.
 - C) The client valued ending inventory at selling price rather than historical cost.
 - D) The client valued ending inventory by using the First-In-First-Out (FIFO) method, but showed the replacement cost of inventory in the Notes to the Financial Statements.

Answer: D

Terms: Issuance of unqualified report

Diff: Challenging

Objective: LO 3-1

AACSB: Reflective thinking skills

- 17) Brown Co.'s financial statements adequately disclose uncertainties that concern future events, the outcome of which are not reasonably estimable. The auditor's report should be a(n):

- A) unqualified opinion.
- B) disclaimer.
- C) qualified opinion.
- D) adverse opinion.

Answer: A

Terms: Adequately disclosed uncertainties

Diff: Challenging

Objective: LO 3-1

AACSB: Reflective thinking skills

18) An audit report prepared by Garrett and Brown, CPAs, is provided below. The audit for the year ended December 31, 2012 was completed on March 1, 2013, and the report was issued to Javlin Corporation, a private company, on March 13, 2013. List any deficiencies in this report. Do not rewrite the report.

We have examined the accompanying financial statements of Dalton Corporation as of December 31, 2012. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these statements based on our audit.

We conducted our audit in accordance with generally accepted accounting principles. Those principles require that we plan and perform the audit to provide reasonable assurance about whether the financial statements are free of misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, except for the effects of not capitalizing certain lease obligations that should be capitalized in order to conform with generally accepted accounting principles, the financial statements referred to above present accurately the financial position of Jacob Corporation as of December 31, 2012, in conformity with accounting principles generally accepted in the United States of America.

Garrett and Brown, CPAs

March, 2013

Answer: The audit report contains the following deficiencies:

- The report title is missing.
- The report is not addressed to anyone and should be addressed to shareholders or the board of directors.
- The introductory paragraph should refer to an "audit," not an "examination."
- The introductory paragraph should list the financial statements that were audited.
- The introductory paragraph refers to the wrong company.
- The scope paragraph should state the audit was conducted in accordance with auditing standards generally accepted in the United States of America, not generally accepted accounting principles.
- "Those principles ..." should read "Those *standards* require that we plan and perform the audit to *obtain* reasonable assurance about whether the financial statements are free of *material* misstatements."
- The scope paragraph should contain the following phrase: "An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation."
- Following the scope paragraph, there should be an explanatory paragraph that discusses the GAAP violation related to the failure to capitalize certain lease obligations.
- In the opinion paragraph, the auditor should state that the financial statements present *fairly...*, not present *accurately...*
- In the opinion paragraph, the phrase "...in all material respects..." should be included.
- In the opinion paragraph, the phrase "...and the results of its operations and its cash flows for the year then ended..." should be included.
- The audit report should be dated March 1, 2013.

Terms: Audit report deficiencies

Diff: Challenging

Objective: LO 3-1

AACSB: Analytic skills

19) Describe the standard unqualified report to be issued for an audit of a private company. Begin by specifying the seven parts of the report, and then discuss the contents of each part.

Answer: The parts of the standard unqualified report are as follows:

- *Report title.* The title must include the word "independent." Examples of appropriate titles are "independent auditor's report," or "report of independent accountant."
- *Report address.* The report is usually addressed to the company's stockholders or board of directors. It should not be addressed to company management.
- *Introductory paragraph.* There are three important components of the introductory paragraph. First, it states that an audit was performed. Second, it lists the financial statements that were audited and their dates. Third, it states that management is responsible for the financial statements, and that the auditor is responsible for expressing an opinion on those statements based on an audit.
- *Scope paragraph.* The scope paragraph is a factual statement about what was done during the audit. It first states that auditing standards generally accepted in the United States of America were followed by the auditor. It then states that an audit is designed to obtain reasonable assurance about whether the statements are free of material misstatement. It concludes by stating that the auditor evaluated the appropriateness of the accounting principles used, and estimates made, by management, and of the financial statement disclosures and presentations given.
- *Opinion paragraph.* This paragraph states the auditor's opinion concerning whether the financial statements present fairly the client's financial position and results of its operations and cash flows in conformity with generally accepted accounting principles.
- *Name of CPA firm.* Typically, the name of the CPA firm, and not the name of an individual auditor, is used.
- *Audit report date.* The audit report is normally dated as of the last day of fieldwork.

Terms: Standard unqualified report □ seven parts of the report

Diff: Challenging

Objective: LO 3-1

AACSB: Reflective thinking skills

20) Presented below is an independent auditor's report for a private company prepared by the firm of Harrington and Perry, LLP.

Auditor's Report

To the president and management of EPM, Inc.

We have examined the accompanying balance sheets and statements of income, retained earnings, and cash flows of EPM, Inc., as of December 31, 2012 and 2011. We performed our examination in accordance with auditing standards generally accepted in the United States of America and examined, on a test basis, evidence supporting the accounting principles used and estimates made by management.

In our opinion, the financial statements referred to above accurately present the financial position of EPM, Inc., in conformity with generally accepted accounting principles.

Harrington and Perry, LLP
December 31, 2012

Other information:

EPM, Inc., is a for-profit corporation and publishes comparative financial statements for distribution to shareholders, potential investors, and the general public. The client has a calendar year-end. For the most recent audit, the auditor completed all significant fieldwork on March 5, 2013 and issued the audit report on March 16, 2013. During 2012, EPM changed its method of depreciating long-term assets and properly reflected the effect of the change in the current year's financial statements, restated the prior year's financial statements, and properly discussed the change in a footnote (Note 4) to those statements. The auditors are satisfied that the change was preferable.

Required:

Consider all the facts given and rewrite the complete auditor's report, including report title, address, body of report, name of firm, and audit report date.

Answer: **Independent Auditor's Report**

To the shareholders of EPM, Inc.

We have audited the accompanying balance sheets of EPM, Inc., as of December 31, 2012 and 2011, and the related statements of income, retained earnings, and cash flows for the years then ended. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of EPM, Inc., as of December 31, 2012 and 2011, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

As discussed in Note 4 to the financial statements, EPM, Inc., changed its method of computing depreciation.

Harrington and Perry, LLP

March 5, 2013

Terms: Audit report format for private company

Diff: Challenging

Objective: LO 3-1

AACSB: Analytic skills

21) The financial statements most commonly audited by external auditors are the balance sheet, the income statement, and the statement of changes in retained earnings.

A) True

B) False

Answer: B

Terms: Financial statements most commonly audited

Diff: Easy

Objective: LO 3-1

AACSB: Reflective thinking skills

22) AICPA professional standards provide uniform wording for the auditor's report to enable users of the financial statements understand the audit report.

A) True

B) False

Answer: A

Terms: Uniform wording for auditor's report

Diff: Easy

Objective: LO 3-1

AACSB: Reflective thinking skills

23) Users of the financial statements rely on the auditor's report because it provides absolute assurance

the report provides.

A) True

B) False

Answer: B

Terms: Users of financial statements rely on auditor's report

Diff: Easy

Objective: LO 3-1

AACSB: Reflective thinking skills

24) The introductory paragraph of the auditor's report states that the auditor is responsible for the preparation, presentation and opinion on financial statements.

A) True

B) False

Answer: B

Terms: Introductory paragraph of auditor's report

Diff: Easy

Objective: LO 3-1

AACSB: Reflective thinking skills

25) The audit report date is the date the auditor completed audit procedures in the field.

A) True

B) False

Answer: A

Terms: Audit report date

Diff: Easy

Objective: LO 3-1

AACSB: Reflective thinking skills

26) Audit reports issued for financial statements of a public company should refer to generally accepted auditing standards in the scope paragraph.

A) True

B) False

Answer: B

Terms: Audit reports issued for financial statements of public company; Scope paragraph

Diff: Easy

Objective: LO 3-1

AACSB: Reflective thinking skills

Topic: Public

27) Audit reports issued for financial statements of a private company should refer to generally accepted auditing standards in the scope paragraph.

A) True

B) False

Answer: A

Terms: Audit reports issued for financial statements of private company; Scope paragraph; Generally accepted auditing standards

Diff: Easy

Objective: LO 3-1

AACSB: Reflective thinking skills

28) The audit report is normally addressed to the company's president or chief executive officer.

A) True

B) False

Answer: B

Terms: Audit report normally addressed

Diff: Easy

Objective: LO 3-1

AACSB: Reflective thinking skills

29) The phrase "generally accepted accounting principles" can be found in the opinion paragraph of a standard unqualified report.

A) True

B) False

Answer: A

Terms: Generally accepted accounting principles; Opinion paragraph of standard unqualified report

Diff: Easy

Objective: LO 3-1

AACSB: Reflective thinking skills

30) The date of the auditor's report is indicative of the last day of the auditor's responsibility for the review of significant events occurring after the balance sheet date.

A) True

B) False

Answer: A

Terms: Date of auditor's report indicates auditor's responsibility

Diff: Moderate

Objective: LO 3-1

AACSB: Reflective thinking skills

31) The phrase "auditing standards generally accepted in the United States of America" can be found in the opinion paragraph of a standard, unqualified audit report for a public company.

A) True

B) False

Answer: B

Terms: Auditing standards generally accepted in the United States; Opinion paragraph in standard unqualified report for public company

Diff: Moderate

Objective: LO 3-1

AACSB: Reflective thinking skills

Topic: Public

32) The phrase "The audit is designed to obtain reasonable assurance about whether the statements are free of material misstatements" is included in the introductory paragraph of an audit report.

A) True

B) False

Answer: B

Terms: Introductory paragraph in audit report; Audit designed to obtain reasonable assurance

Diff: Moderate

Objective: LO 3-1

AACSB: Reflective thinking skills

Learning Objective 3-2

1) There are no questions for this Learning Objective.

Answer:

Learning Objective 3-3

1) Whenever an auditor issues an audit report for a public company, the auditor can choose to issue a report in which of the following forms?

I. A combined report on financial statements and internal control over financial reporting.

II. Separate reports on financial statements and internal control over financial reporting.

A) I only

B) II only

C) Either I or II.

D) Neither I nor II.

Answer: C

Terms: Audit report for public company

Diff: Easy

Objective: LO 3-3

AACSB: Reflective thinking skills

Topic: Public

2) PCAOB Auditing Standard No. 2 requires the audit of internal control over financial reporting to be integrated with:

A) the audit of the financial statements.

B) the quarterly review of financial information.

C) the review of annual financial statements.

D) None of the above.

Answer: A

Terms: PCAOB Auditing Standard No. 2; Audit of internal control over financial reporting

Diff: Moderate

Objective: LO 3-3

AACSB: Reflective thinking skills

Topic: Public

3) A combined report on financial statements and internal control over financial reporting includes all but which of the following types of paragraphs?

A) Inherent limitations paragraph

B) Description paragraph

C) Opinion paragraph

D) Each of the above paragraphs is included.

Answer: B

Terms: Combined report on financial statements and internal control over financial reporting

Diff: Moderate

Objective: LO 3-3

AACSB: Reflective thinking skills

Topic: Public

4) There are five conditions that must be met before an auditor can issue a standard unqualified report for the audit of a private company. Please discuss each of these five conditions.

Answer: The five conditions that justify issuing a standard unqualified report are:

- All statements—balance sheet, income statement, statement of retained earnings, and statement of cash flows—are included in the financial statements.
- The three general standards of GAAS have been followed in all respects on the engagement.
- Sufficient appropriate audit evidence has been accumulated and the auditor has conducted the engagement in a manner that enables him or her to conclude that the three fieldwork standards have been followed.
- The financial statements are presented in accordance with U.S. GAAP. This also means that adequate disclosures have been included in the footnotes and other parts of the financial statements.
- There are no circumstances requiring the addition of an explanatory paragraph or modification of the wording of the report.

Terms: Conditions for standard unqualified report for audit of private company

Diff: Moderate

Objective: LO 3-3

AACSB: Reflective thinking skills

5) Section 404(b) of the Sarbanes Oxley Act requires that the auditor of an issuer attest to management's report on the efficiency of internal controls over financial reporting.

A) True

B) False

Answer: B

Terms: Section 404(b) of Sarbanes-Oxley Act; Internal controls over financial reporting

Diff: Moderate

Objective: LO 3-3

AACSB: Reflective thinking skills

Topic: Public

6) Auditors of public company financial statements must issue separate reports on internal control over financial reporting.

A) True

B) False

Answer: B

Terms: Auditors issue separate reports on internal control

Diff: Moderate

Objective: LO 3-3

AACSB: Reflective thinking skills

Topic: Public

Learning Objective 3-4

1) Examples of unqualified opinions which contain modified wording (without adding an explanatory paragraph) include:

- A) the use of other auditors.
- B) material uncertainties.
- C) substantial doubt about the audited company (or the entity) continuing as a going concern.
- D) lack of consistent application of GAAP.

Answer: A

Terms: Modified unqualified opinion

Diff: Easy

Objective: LO 3-4

AACSB: Reflective thinking skills

2) A CPA may wish to emphasize specific matters regarding the financial statements even though an unqualified opinion will be issued. Normally, such explanatory information is:

- A) included in the scope paragraph.
- B) included in the opinion paragraph.
- C) included in a separate paragraph in the report.
- D) included in the introductory paragraph.

Answer: C

Terms: Unqualified opinion with emphasis on specific matters regarding the financial statements

Diff: Easy

Objective: LO 3-4

AACSB: Reflective thinking skills

3) All of the following are conditions requiring a departure from a standard unqualified audit report except:

- A) management refused to allow the auditor to confirm significant accounts receivable for which there were no alternative procedures performed.
- B) Management decided not to allow the auditor to confirm significant accounts receivable, but the auditor obtained sufficient appropriate evidence by examining subsequent cash receipts.
- C) part of the audit was performed by other auditors whose report was furnished to the principle auditor.
- D) management has determined that fixed assets should be reported in the balance sheet at their replacement values rather than historical costs. The auditors do not concur.

Answer: B

Terms: Departure from unqualified audit report

Diff: Moderate

Objective: LO 3-4

AACSB: Reflective thinking skills

4) Which of the following is not a cause for a modification of the format for a standard unqualified auditor's report?

- A) Substantial doubt about an entity's ability to continue as a going concern.
- B) Reports involving other auditors.
- C) A departure from promulgated accounting principles.
- D) Not consistently applying accounting principles.

Answer: C

Terms: Report modifications

Diff: Moderate

Objective: LO 3-4

AACSB: Reflective thinking skills

5) Which of the following are changes that affect the comparability of financial statements but not the consistency and therefore, do not have to be included in the auditor's report?

- A) Error corrections not involving principles
- B) Changes in accounting estimates
- C) Variations in the format and presentation of financial information
- D) All of the above.

Answer: D

Terms: Changes that affect the comparability of financial statements

Diff: Moderate

Objective: LO 3-4

AACSB: Reflective thinking skills

6) Which of the following is least likely to cause uncertainty about the ability of an entity to continue as a going concern?

- A) A potential lawsuit against the entity for a patent infringement.
- B) Loss of major customers.
- C) Significant recurring operating losses.
- D) Working capital deficiencies.

Answer: A

Terms: Going concern

Diff: Moderate

Objective: LO 3-4

AACSB: Reflective thinking skills

7) When there is uncertainty about a company's ability to continue as a going concern, the auditor's concern is the possibility that the client may not be able to continue its operations or meet its obligations for a "reasonable period of time." For this purpose, a reasonable period of time is considered not to exceed:

- A) six months from the date of the financial statements.
- B) one year from the date of the financial statements.
- C) six months from the date of the audit report.
- D) one year from the date of the audit report.

Answer: B

Terms: Going concern ; time period

Diff: Moderate

Objective: LO 3-4

AACSB: Reflective thinking skills

8) When the auditor concludes that there is substantial doubt about the entity's ability to continue as a going concern, the appropriate audit report could be:

I. an unqualified opinion with an explanatory paragraph.

II. a disclaimer of opinion.

A) I only

B) II only

C) I or II

D) Neither I nor II

Answer: C

Terms: Auditor concludes substantial doubt about entity's ability to continue as going concern

Diff: Moderate

Objective: LO 3-4

AACSB: Reflective thinking skills

9) When a company's financial statements contain a departure from GAAP with which the auditor concurs, the departure should be explained in:

A) the scope paragraph.

B) an explanatory paragraph that appears before the opinion paragraph.

C) the opinion paragraph.

D) an explanatory paragraph after the opinion paragraph.

Answer: B

Terms: Justified Departure

Diff: Moderate

Objective: LO 3-4

AACSB: Reflective thinking skills

10) William Gregory, CPA, is the principal auditor for a multi-national corporation. Another CPA has examined and reported on the financial statements of a significant subsidiary of the corporation. Gregory is satisfied with the independence and professional reputation of the other auditor, as well as the quality of the other auditor's examination. With respect to his report on the consolidated financial statements, taken as a whole, Gregory:

A) must not refer to the examination of the other auditor.

B) must refer to the examination of the other auditor.

C) may refer to the examination of the other auditor.

D) must refer to the examination of the other auditors along with the percentage off consolidated assets and revenue that they audited.

Answer: C

Terms: Reports involving other auditors

Diff: Moderate

Objective: LO 3-4

AACSB: Reflective thinking skills

11) A company has changed its method of inventory valuation from an unacceptable one to one in conformity with generally accepted accounting principles. The auditor's report on the financial statements of the year of the change should include:

- A) no reference to consistency.
- B) a reference to a prior period adjustment in the opinion paragraph.
- C) an explanatory paragraph that justifies the change and explains the impact of the change on reported net income.
- D) an explanatory paragraph explaining the change.

Answer: D

Terms: Consistency modifications

Diff: Moderate

Objective: LO 3-4

AACSB: Reflective thinking skills

12) Which of the following modifications of the auditor's report does not include an explanatory paragraph?

- A) A qualified report due to a GAAP departure.
- B) The report includes an emphasis of a matter.
- C) There is a very material scope limitation.
- D) A principle auditor accepts the work of an other auditor.

Answer: D

Terms: Shared opinions

Diff: Moderate

Objective: LO 3-4

AACSB: Reflective thinking skills

13) No reference is made in the auditor's report to other auditors who perform a portion of the audit when:

- I. The other auditor audited an immaterial portion of the audit.
- II. The other auditor is well known or closely supervised by the principle auditor.
- III. The principle auditor has thoroughly reviewed the work of the other auditor.

- A) I and II
- B) I and III
- C) II and III
- D) I, II and III

Answer: D

Terms: Shared opinions

Diff: Moderate

Objective: LO 3-4

AACSB: Reflective thinking skills

14) Readers of financial statements often interpret that the number of paragraphs in the independent auditor's report is a "signal" of the entity's financial fairness. Which of the following is not true regarding the number of paragraphs in an independent auditor's report?

- A) More than three paragraphs indicates either a qualification or report modification.
- B) An additional paragraph is added before the opinion for a qualified, adverse or disclaimer of opinion.
- C) An additional paragraph is added after the opinion when there is required information the auditor must report when the opinion is unqualified.
- D) No explanatory paragraph is required for an unqualified shared report involving other auditors, however, explanatory language is added in the introductory paragraph.

Answer: D

Terms: Number of paragraphs in independent auditor's report

Diff: Challenging

Objective: LO 3-4

AACSB: Reflective thinking skills

15) Which of the following circumstances would not require more than one report modification in from the standard unqualified independent auditor's report?

- A) There is a GAAP departure and accounting principles were not consistently applied with that of the preceding year.
- B) There is a scope limitation and the auditor's are not independent.
- C) There is a scope limitation and there is substantial doubt about the entity's ability to continue as a going concern.
- D) There is substantial doubt about the entity's ability to continue as a going concern and the causes of these uncertainties are not adequately disclosed in a footnote.

Answer: B

Terms: Multiple report modifications from standard unqualified report

Diff: Challenging

Objective: LO 3-4

AACSB: Analytic skills

16) Which of the following is not an unqualified opinion with modified wording?

- A) Emphasis of a matter.
- B) Reports involving other auditors.
- C) Auditor disagrees with client's departure from GAAP.
- D) Lack of consistent application of GAAP.

Answer: C

Terms: Unqualified opinion with modified wording

Diff: Challenging

Objective: LO 3-4

AACSB: Reflective thinking skills

17) Which of the following is false concerning the principal CPA firm's alternatives when issuing a report when another CPA firm performs part of the audit?

- A) Issue a joint report signed by both CPA firms.
- B) Make no reference to the other CPA firm in the audit report, and issue the standard unqualified opinion.
- C) Make reference to the other auditor in the report by using modified wording (a shared opinion or report).
- D) A qualified opinion or disclaimer, depending on materiality, is required if the principal auditor is not willing to assume any responsibility for the work of the other auditor.

Answer: A

Terms: Shared opinions

Diff: Challenging

Objective: LO 3-4

AACSB: Reflective thinking skills

18) Which of the following requires recognition in the auditor's opinion as to consistency?

- A) The correction of an error in the prior year's financial statements resulting from a mathematical mistake in capitalizing interest.
- B) A change in the estimate of provisions for warranty costs.
- C) The change from the cost method to the equity method of accounting for investments in common stock.
- D) A change in depreciation method which has no effect on current year's financial statements but is certain to affect future years.

Answer: C

Terms: Consistency

Diff: Challenging

Objective: LO 3-4

AACSB: Reflective thinking skills

19) Indicate which changes would require an explanatory paragraph in the audit report.

A)

Correction of an error by changing from an accounting principle that is not generally acceptable to one that is generally acceptable	Change from LIFO to FIFO
Yes	Yes

B)

Correction of an error by changing from an accounting principle that is not generally acceptable to one that is generally acceptable	Change from LIFO to FIFO
No	No

C)

Correction of an error by changing from an accounting principle that is not generally acceptable to one that is generally acceptable	Change from LIFO to FIFO
Yes	No

D)

Correction of an error by changing from an accounting principle that is not generally acceptable to one that is generally acceptable	Change from LIFO to FIFO
No	Yes

Answer: A

Terms: Changes that require explanatory paragraph in audit report

Diff: Moderate

Objective: LO 3-4

AACSB: Reflective thinking skills

20) Indicate which changes would require an explanatory paragraph in the audit report.

A)

Change in the estimated life of an asset	Variation in the format of the financial statements
Yes	Yes

B)

Change in the estimated life of an asset	Variation in the format of the financial statements
No	No

C)

Change in the estimated life of an asset	Variation in the format of the financial statements
Yes	No

D)

Change in the estimated life of an asset	Variation in the format of the financial statements
No	Yes

Answer: B

Terms: Changes that require explanatory paragraph in audit report

Diff: Moderate

Objective: LO 3-4

AACSB: Reflective thinking skills

21) Indicate which changes would require an explanatory paragraph in the audit report.

A)

The CPA concludes there is substantial doubt about the entity's ability to continue as a going concern	Change from FIFO to LIFO
Yes	Yes

B)

The CPA concludes there is substantial doubt about the entity's ability to continue as a going concern	Change from FIFO to LIFO
No	No

C)

The CPA concludes there is substantial doubt about the entity's ability to continue as a going concern	Change from FIFO to LIFO
Yes	No

D)

The CPA concludes there is substantial doubt about the entity's ability to continue as a going concern	Change from FIFO to LIFO
No	Yes

Answer: A

Terms: Changes that would require an explanatory paragraph in audit report

Diff: Moderate

Objective: LO 3-4

AACSB: Reflective thinking skills

22) Indicate which changes would require an explanatory paragraph in the audit report.

A)

A departure from GAAP which, due to unusual circumstances, does not require a qualified or adverse opinion.	The CPA makes reference to the work of another auditor to indicate shared responsibility in an unqualified opinion.
Yes	Yes

B)

A departure from GAAP which, due to unusual circumstances, does not require a qualified or adverse opinion.	The CPA makes reference to the work of another auditor to indicate shared responsibility in an unqualified opinion.
No	No

C)

A departure from GAAP which, due to unusual circumstances, does not require a qualified or adverse opinion.	The CPA makes reference to the work of another auditor to indicate shared responsibility in an unqualified opinion.
Yes	No

D)

A departure from GAAP which, due to unusual circumstances, does not require a qualified or adverse opinion.	The CPA makes reference to the work of another auditor to indicate shared responsibility in an unqualified opinion.
No	Yes

Answer: C

Terms: Changes that would require an explanatory paragraph in audit report

Diff: Challenging

Objective: LO 3-4

AACSB: Reflective thinking skills

23) In certain circumstances, an auditor will issue modified unqualified report. Discuss each of the five circumstances when an auditor would issue an unqualified report with an explanatory paragraph or modified wording.

Answer: An unqualified report with an explanatory paragraph or modified wording is appropriate in the following circumstances:

- *Lack of consistent application of GAAP.* When the client has not followed generally accepted accounting principles consistently in the current period in relation to the preceding period, an unqualified opinion with an explanatory paragraph following the opinion paragraph is appropriate.
- *Substantial doubt about continuing as a going concern.* When an auditor concludes there is substantial doubt about the client's ability to continue as a going concern, an unqualified opinion with an explanatory paragraph following the opinion paragraph is appropriate. The auditor also has the option of issuing a disclaimer of opinion.
- *A departure from GAAP with which the auditor concurs.* If adherence to GAAP would result in misleading financial statements, an unqualified opinion with an explanatory paragraph is appropriate.
- *Emphasis of a matter.* If the auditor wants to emphasize specific matters in the audit report, an explanatory paragraph discussing those matters may be added to an unqualified report.
- *Reports involving other auditors.* When an auditor relies upon a different CPA firm to perform part of the audit, the auditor can indicate that responsibility for the audit is shared with another CPA firm by modifying the wording of an unqualified report.

Terms: Circumstances where an auditor will issue modified unqualified report with explanatory paragraph or modified wording

Diff: Moderate

Objective: LO 3-4

AACSB: Reflective thinking skills

24) A modified unqualified auditor report arises when the auditor believes the financials are fairly stated but also believes additional information should be provided.

A) True

B) False

Answer: A

Terms: Modified unqualified audit report

Diff: Easy

Objective: LO 3-4

AACSB: Reflective thinking skills

25) Changes of an accounting estimate requires the auditor to issue a modified unqualified audit report with a consistency paragraph is inserted after the opinion paragraph.

A) True

B) False

Answer: B

Terms: Changes of accounting estimates; Modified unqualified audit report

Diff: Moderate

Objective: LO 3-4

AACSB: Reflective thinking skills

26) The only modified unqualified opinion that does not include an explanatory paragraph is when other auditors are involved. In this case only the introductory paragraph is modified.

A) True

B) False

Answer: B

Terms: Modified unqualified opinion

Diff: Moderate

Objective: LO 3-4

AACSB: Reflective thinking skills

27) Items that materially affect the comparability of the financial statements generally require disclosure in the footnotes.

A) True

B) False

Answer: A

Terms: Items that materially affect comparability of financial statements

Diff: Moderate

Objective: LO 3-4

AACSB: Reflective thinking skills

28) Changes in an estimate, such as a change in the estimated useful life of an asset for depreciation purposes, affect consistency but not comparability, and therefore require an explanatory paragraph in the audit report.

A) True

B) False

Answer: B

Terms: Comparability vs. consistency

Diff: Moderate

Objective: LO 3-4

AACSB: Reflective thinking skills

29) Changes in reporting entities, such as the inclusion of an additional company in combined financial statements, affect comparability but not consistency, and therefore do **not** require an explanatory paragraph in the audit report.

A) True

B) False

Answer: B

Terms: Comparability and consistency

Diff: Challenging

Objective: LO 3-4

AACSB: Reflective thinking skills

30) When an auditor relies upon a different CPA firm to perform part of the audit and chooses to issue a shared opinion, the wording of the report should be modified in all three paragraphs.

A) True

B) False

Answer: A

Terms: Auditor reliance on different CPA firm to perform part of audit; Shared opinion

Diff: Moderate

Objective: LO 3-4

AACSB: Reflective thinking skills

31) When other auditors are involved in the audit and they qualify their portion of the audit, the principle auditor must decide if the amount in question is material to the financial statements as a whole.

A) True

B) False

Answer: A

Terms: Shared responsibility

Diff: Challenging

Objective: LO 3-4

AACSB: Reflective thinking skills

Learning Objective 3-5

1) As a result of management's refusal to permit the auditor to physically examine inventory. The auditor must depart from the unqualified audit report because:

A) the financial statements have not been prepared in accordance with GAAP.

B) the scope of the audit has been restricted by circumstances beyond either the client's or auditor's control.

C) the financial statements have not been audited in accordance with GAAS.

D) the scope of the audit has been restricted.

Answer: D

Terms: Auditor must depart from unqualified audit report; Management refusal to permit the auditor to physically examine inventory

Diff: Easy

Objective: LO 3-5

AACSB: Reflective thinking skills

2) An adverse opinion is issued when the auditor believes:

A) some parts of the financial statements are materially misstated or misleading.

B) the financial statements would be found to be materially misstated if an investigation were performed.

C) the auditor is not independent.

D) the overall financial statements are so materially misstated that they do not present fairly the financial position or results of operations and cash flows in conformity with GAAP.

Answer: D

Terms: Adverse opinion

Diff: Easy

Objective: LO 3-5

AACSB: Reflective thinking skills

3) An auditor can express a qualified opinion due to a:

A)

Departure from GAAP	Lack of Consistency	Lack of Sufficient Evidence
Yes	No	No

B)

Departure from GAAP	Lack of Consistency	Lack of Sufficient Evidence
No	Yes	No

C)

Departure from GAAP	Lack of Consistency	Lack of Sufficient Evidence
Yes	No	Yes

D)

Departure from GAAP	Lack of Consistency	Lack of Sufficient Evidence
Yes	Yes	Yes

Answer: C

Terms: Qualified opinions

Diff: Easy

Objective: LO 3-5

AACSB: Reflective thinking skills

4) An auditor determines the financial statements include at least a material departure from GAAP. Which type of opinion may be issued?

A)

Disclaimer	Qualified	Adverse
Yes	No	No

B)

Disclaimer	Qualified	Adverse
No	Yes	No

C)

Disclaimer	Qualified	Adverse
Yes	No	Yes

D)

Disclaimer	Qualified	Adverse
No	Yes	Yes

Answer: D

Terms: Opinion , GAAP departure

Diff: Moderate

Objective: LO 3-5

AACSB: Reflective thinking skills

5) A qualified opinion can be issued for which of the following?

- I. When a limitation on the scope of the audit has occurred.
- II. When the auditor lacks independence.
- III. When generally accepted accounting principles have not been used.

- A) I and II
- B) I and III
- C) II and III
- D) I, II and III

Answer: B

Terms: Qualified opinion

Diff: Moderate

Objective: LO 3-5

AACSB: Reflective thinking skills

6) In which situation would the auditor be choosing between "except for" qualified opinion and an adverse opinion?

- A) The auditor lacks independence.
- B) A client-imposed scope limitation.
- C) A circumstance imposed scope limitation.
- D) Lack of full disclosure within the footnotes.

Answer: D

Terms: Qualified opinion and adverse opinion

Diff: Moderate

Objective: LO 3-5

AACSB: Reflective thinking skills

7) When the auditor determines the financial statements are fairly stated and then determines that the auditor lacks independence, the auditor should issue:

- A) an adverse opinion.
- B) a disclaimer of opinion.
- C) either a qualified opinion or an adverse opinion.
- D) either a qualified opinion or an unqualified opinion with modified wording.

Answer: B

Terms: Audit report when auditor not independent

Diff: Moderate

Objective: LO 3-5

AACSB: Reflective thinking skills

8) If the auditor lacks independence, a disclaimer of opinion must be issued:

- A) if the client requests it.
- B) only if it is highly material.
- C) only if it is material but not pervasive.
- D) in all cases.

Answer: D

Terms: Disclaimer when auditor lacks independence

Diff: Moderate

Objective: LO 3-5

AACSB: Reflective thinking skills

9) When a disclaimer is issued because the auditor lacks independence:

- A) no report title is included on the report.
- B) a one-paragraph audit report is issued.
- C) the only reason cited for issuing the disclaimer is the lack of independence.
- D) all of the above are correct.

Answer: D

Terms: Disclaimer issued if auditor lacks independence

Diff: Moderate

Objective: LO 3-5

AACSB: Reflective thinking skills

10) When a client has changed their method of valuing inventory from FIFO to LIFO and the change has a material effect on the financial statements. If the auditor does not concur with the appropriateness of the change, the auditor should issue a(n):

- A) disclaimer.
- B) adverse opinion.
- C) unqualified opinion.
- D) qualified opinion.

Answer: D

Terms: Change in valuing inventory and auditor does not concur with change

Diff: Moderate

Objective: LO 3-5

AACSB: Reflective thinking skills

11) Items that materially affect the comparability of financial statements generally require disclosure in the footnotes. If the client refuses to properly disclose the item, the auditor will most likely issue:

- A) a disclaimer.
- B) an unqualified opinion.
- C) a qualified opinion.
- D) an adverse opinion.

Answer: C

Terms: Disclosure and comparability

Diff: Moderate

Objective: LO 3-5

AACSB: Reflective thinking skills

12) Which of the following scenarios does not result in a qualified opinion?

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

Answer: C

Terms: Qualified opinion

Diff: Moderate

Objective: LO 3-5

AACSB: Reflective thinking skills

13) Whenever the client imposes restrictions on the scope of the audit, the auditor should be concerned that management may be trying to prevent discovery of misstatements. In such cases, the auditor will likely issue a:

- A) disclaimer of opinion in all cases.
- B) qualification of both scope and opinion in all cases.
- C) disclaimer of opinion whenever materiality is in question.
- D) qualification of both scope and opinion whenever materiality is in question.

Answer: C

Terms: Client imposed restrictions on scope of audit

Diff: Moderate

Objective: LO 3-5

AACSB: Reflective thinking skills

14) In which of the following circumstances would an auditor most likely express an adverse opinion?

- A) The CEO refuses to let the auditor have access to the board of director meeting minutes.
- B) The financial statements are not in conformity with the FASB statement on loss contingencies.
- C) Information comes to the auditor's attention that raises substantial doubt about the ability for the client to continue as a going concern.
- D) Tests of controls show that the internal control structure is so poor that the auditor has to assess control risk at the maximum.

Answer: B

Terms: Adverse opinion circumstances

Diff: Moderate

Objective: LO 3-5

AACSB: Reflective thinking skills

15) Which of the following statements is true?

- I. The auditor is required to issue a disclaimer of opinion in the event of a material uncertainty.
- II. The auditor is required to issue a disclaimer of opinion in the event of a going concern problem.

- A) I only
- B) II only
- C) I and II
- D) Neither I nor II

Answer: D

Terms: Disclaimer of opinion

Diff: Challenging

Objective: LO 3-5

AACSB: Reflective thinking skills

16) The most common case in which conditions beyond the client's and auditor's control cause a scope restriction is an engagement:

- A) agreed upon after the client's balance sheet date.
- B) where the client won't allow the auditor to confirm receivables for fear of offending its customers.
- C) where the auditor doesn't have enough staff to satisfactorily audit all of the client's foreign subsidiaries.
- D) where the client is going through Chapter 11 bankruptcy.

Answer: A

Terms: Scope restriction beyond client and auditor control

Diff: Challenging

Objective: LO 3-5

AACSB: Reflective thinking skills

17) When the client fails to make adequate disclosure in the body of the statements or in the related footnotes, it is the responsibility of the auditor to:

- A) inform the reader that disclosure is not adequate, and to issue an adverse opinion.
- B) inform the reader that disclosure is not adequate, and to issue a qualified opinion.
- C) present the information in the audit report and issue an unqualified or qualified opinion.
- D) present the information in the audit report and to issue a qualified or an adverse opinion.

Answer: D

Terms: Inadequate disclosure

Diff: Challenging

Objective: LO 3-5

AACSB: Reflective thinking skills

18) There are three conditions necessitating a departure from an unqualified audit report. Name, discuss and state the appropriate audit report for each of these three conditions.

Answer: The three conditions requiring a departure from an unqualified report are:

- Scope Restrictions. A scope restriction can be imposed by the client or due to circumstances beyond the auditor's or client's control. In either case the scope restriction prevents the auditor from accumulating sufficient evidence to reach a conclusion regarding whether financial statements are stated in accordance with GAAP. The type of opinion, depending upon materiality, would be either a qualified or a disclaimer of opinion report.
- GAAP Departures. In this situation the financial statements are not prepared in accordance with GAAP. Accordingly, the auditor would issue a qualified opinion if the GAAP violation were moderately material, or an adverse opinion if the GAAP violation were highly material.
- Auditor lacks independence. Independence ordinarily determined by Rule 101 of the rules of the Code of Professional Conduct. When the auditor is not independent the only report the auditor can issue is a disclaimer of opinion.

Terms: Conditions necessitating a departure from an unqualified audit report

Diff: Moderate

Objective: LO 3-5

AACSB: Reflective thinking skills

19) A qualified report is issued when all auditing conditions have been met, no significant misstatements have been discovered, and it is the auditor's opinion that the financial statements are fairly stated in accordance with GAAP.

A) True

B) False

Answer: B

Terms: Qualified report

Diff: Easy

Objective: LO 3-5

AACSB: Reflective thinking skills

20) Auditors should issue a disclaimer of opinion when there is a highly material client-imposed scope restriction.

A) True

B) False

Answer: B

Terms: Disclaimer of opinion; Client-imposed scope restriction

Diff: Moderate

Objective: LO 3-5

AACSB: Reflective thinking skills

21) Whenever an auditor issues a qualified report, he or she must use the term "except for" in the opinion paragraph.

A) True

B) False

Answer: A

Terms: Qualified report; Except for in opinion paragraph

Diff: Moderate

Objective: LO 3-5

AACSB: Reflective thinking skills

22) Whenever an auditor issues a qualified report due to a scope limitation, he/she must use the term "except for" in both the scope and opinion paragraph.

A) True

B) False

Answer: A

Terms: Qualified report; Scope limitation

Diff: Moderate

Objective: LO 3-5

AACSB: Reflective thinking skills

23) When an auditor discovers a highly material GAAP violation in the financial statements and the client refuses to correct it, the auditor should issue a disclaimer of opinion.

A) True

B) False

Answer: B

Terms: Disclaimer of opinion; Highly material GAAP violation in the financial statements and client refuses to correct it

Diff: Moderate

Objective: LO 3-5

AACSB: Reflective thinking skills

24) Client imposed restrictions on the audit always require a disclaimer of opinion.

A) True

B) False

Answer: B

Terms: Disclaimer of opinion; Client imposed restrictions on audit

Diff: Moderate

Objective: LO 3-5

AACSB: Reflective thinking skills

25) An auditor should issue a qualified opinion with an explanatory paragraph whenever there is a material uncertainty affecting the financial statements.

A) True

B) False

Answer: B

Terms: Qualified opinion with explanatory paragraph

Diff: Moderate

Objective: LO 3-5

AACSB: Reflective thinking skills

Learning Objective 3-6

1) When the auditor evaluates the effect of a change in accounting principle, the materiality of the change should be evaluated based on:

- A) the prior years presented.
- B) the current year.
- C) guidelines included in GAAS.
- D) the effect on total assets.

Answer: B

Terms: Effect of change of accounting principle; Materiality of change

Diff: Moderate

Objective: LO 3-6

AACSB: Reflective thinking skills

2) Misstatements must be compared with some measurement base before a decision can be made about materiality. A commonly accepted measurement base includes:

- A) net income.
- B) total assets.
- C) working capital.
- D) all of the above.

Answer: D

Terms: Misstatements and materiality

Diff: Moderate

Objective: LO 3-6

AACSB: Reflective thinking skills

3) When comparing misstatements with a measurement base, the auditor must consider the pervasiveness of the misstatement. Of the following examples, the most pervasive misstatement is a(n):

- A) understatement of inventory.
- B) understatement of retained earnings caused by a miscalculation of dividends payable.
- C) misclassification of notes payable as a long-term liability when it should be current.
- D) misclassification of salary expense as a selling expense.

Answer: A

Terms: Pervasive misstatements

Diff: Moderate

Objective: LO 3-6

AACSB: Reflective thinking skills

4) The dollar amount of some misstatements cannot be accurately measured. For example, if the client were unwilling to disclose an existing lawsuit, the auditor must estimate the likely effect on:

- A) net income.
- B) users of the financial statements.
- C) the auditor's exposure to lawsuits.
- D) management's future decisions.

Answer: B

Terms: Misstatements accurately measured

Diff: Moderate

Objective: LO 3-6

AACSB: Reflective thinking skills

5) Materiality is an essential consideration in determining the appropriate type of report under a given set of circumstances. Which of the following is not considered an immaterial instance that would not cause the financials to become qualified?

- A) Immediately expensing office supplies rather than inventorying them.
- B) Recording prepaid insurance as an asset in the prior year and expensing it in the current year.
- C) A misstatement in property, plant and equipment affects a user's decision.
- D) All of the above are immaterial.

Answer: C

Terms: Materiality qualifications

Diff: Moderate

Objective: LO 3-6

AACSB: Reflective thinking skills

6) When a client fails to follow GAAP, the audit can be unqualified, qualified, or adverse depending on the materiality. What factors affect materiality that an auditor should consider?

- A) The dollar amount in comparison to a base.
- B) If the misstatement can be measured.
- C) The nature of the item.
- D) All the above are factors an auditor should consider regarding materiality.

Answer: D

Terms: Client fails to follow GAAP; Materiality

Diff: Moderate

Objective: LO 3-6

AACSB: Reflective thinking skills

7) When the auditor cannot perform procedures and the amounts are so material that a disclaimer of opinion is required, the:

- A) opinion paragraph will state "does not present fairly."
- B) opinion paragraph will state "presents fairly."
- C) scope paragraph will be unchanged from the standard unqualified opinion.
- D) scope paragraph will be deleted.

Answer: D

Terms: Disclaimer of opinion

Diff: Challenging

Objective: LO 3-6

AACSB: Reflective thinking skills

8) Discuss how materiality affects audit reporting decisions.

Answer: When determining the appropriate audit report to issue, the auditor considers three levels of materiality for a given condition. These three levels are (1) immaterial, (2) material without overshadowing the financial statements as a whole, and (3) so material and so pervasive that overall fairness of the statements is in question. For conditions involving a GAAP violation, the materiality level of the violation influences whether an unqualified, qualified, or adverse opinion is issued. For conditions involving a scope restriction, the materiality of the restriction influences whether an unqualified report, a qualified scope and opinion report, or a disclaimer of opinion is issued.

Terms: Materiality affect on audit reporting decisions

Diff: Easy

Objective: LO 3-6

AACSB: Reflective thinking skills

9) Materiality is essential when an auditor considers his/her determination of the appropriate report for a given set of circumstances.

A) True

B) False

Answer: A

Terms: Materiality; Appropriate report

Diff: Easy

Objective: LO 3-6

AACSB: Reflective thinking skills

10) A pervasive exception is one that affects different parts of the financial statements.

A) True

B) False

Answer: A

Terms: Pervasive exception

Diff: Easy

Objective: LO 3-6

AACSB: Reflective thinking skills

11) An item with a "psychic" effect (e.g., where the item maintains an increasing earnings trend) is a qualitative factor that may affect the auditors decision regarding materiality.

A) True

B) False

Answer: A

Terms: Psychic effect; Materiality

Diff: Challenging

Objective: LO 3-6

AACSB: Reflective thinking skills

Learning Objective 3-7

1) The explanatory paragraph for a qualified opinion would:

A) easy precede the scope paragraph.

B) follow the scope paragraph.

C) follow the opinion paragraph.

D) either precede or follow the opinion paragraph depending on the materiality.

Answer: B

Terms: Explanatory paragraph for qualified opinion

Diff: Easy

Objective: LO 3-7

AACSB: Reflective thinking skills

2) An auditor who issues a qualified opinion because sufficient appropriate evidence was not obtained should describe the limitations in an explanatory paragraph. The auditor should also modify the:

A)

Scope paragraph	Opinion paragraph	Notes to the financial statements
Yes	No	Yes

B)

Scope paragraph	Opinion paragraph	Notes to the financial statements
No	Yes	Yes

C)

Scope paragraph	Opinion paragraph	Notes to the financial statements
No	Yes	No

D)

Scope paragraph	Opinion paragraph	Notes to the financial statements
Yes	Yes	No

Answer: D

Terms: Qualified opinion insufficient evidence

Diff: Challenging

Objective: LO 3-7

AACSB: Reflective thinking skills

3) When an auditor issues a qualified report due to a scope limitation an explanatory paragraph is normally added. Which, if any, of the following paragraphs are also modified?

A)

Introductory	Scope	Opinion
Yes	Yes	Yes

B)

Introductory	Scope	Opinion
Yes	Yes	No

C)

Introductory	Scope	Opinion
No	Yes	No

D)

Introductory	Scope	Opinion
No	Yes	Yes

Answer: D

Terms: Qualified report due to scope restriction; Paragraphs modified

Diff: Moderate

Objective: LO 3-7

AACSB: Reflective thinking skills

4) When a qualified or adverse opinion is issued, the qualifying paragraph is inserted:

- A) between the introductory and scope paragraphs.
- B) between the scope and opinion paragraphs.
- C) after the opinion paragraph, as a fourth paragraph.
- D) immediately after the address, as the first paragraph.

Answer: B

Terms: Qualified or adverse opinion paragraph placement

Diff: Moderate

Objective: LO 3-7

AACSB: Reflective thinking skills

5) The independent auditor must issue a qualified opinion when which of the financial(s) are missing?

- I. Balance Sheet
 - II. Income Statement
 - III. Statement of Cash Flows
- A) I only
 - B) II only
 - C) III only
 - D) I, II, and III

Answer: C

Terms: Qualified opinion issued when which financial statement is missing

Diff: Moderate

Objective: LO 3-7

AACSB: Reflective thinking skills

6) If the financial statements include an income statement and a balance sheet but exclude the statement of cash flows, the auditors:

- A) can issue an unqualified report.
- B) should issue a qualified opinion due to the departure from GAAP.
- C) should issue a qualified opinion because the missing statement of cash flows constitutes a scope limitation.
- D) should include the statement of cash flows, modify the report and issue an unqualified opinion.

Answer: B

Terms: Report when financial statements exclude statement of cash flows

Diff: Moderate

Objective: LO 3-7

AACSB: Reflective thinking skills

7) Which of the following is incorrect concerning scope limitations?

- A) If client imposed the auditor should be concerned about client trying to prevent discovery of a material misstatement.
- B) An unqualified opinion can result if auditors can perform alternative procedures and are satisfied that the information is fairly stated.
- C) The most common circumstance imposed scope restriction is due to the client changing their auditors.
- D) The most common circumstance imposed scope limitation is when the auditor is appointed after the balance sheet date.

Answer: C

Terms: Scope limitation

Diff: Moderate

Objective: LO 3-7

AACSB: Reflective thinking skills

8) When a scope limitation exists in an audit which type of report modification can result?

A)

Qualified Opinion Paragraph Only	Qualified Scope Paragraph Only	Disclaimer Opinion No Scope Paragraph
Yes	No	Yes

B)

Qualified Opinion Paragraph Only	Qualified Scope Paragraph Only	Disclaimer Opinion No Scope Paragraph
No	No	Yes

C)

Qualified Opinion Paragraph Only	Qualified Scope Paragraph Only	Disclaimer Opinion No Scope Paragraph
Yes	Yes	No

D)

Qualified Opinion Paragraph Only	Qualified Scope Paragraph Only	Disclaimer Opinion No Scope Paragraph
No	No	No

Answer: B

Terms: Scope limitation

Diff: Moderate

Objective: LO 3-7

AACSB: Reflective thinking skills

9) When a pervasive scope limitation exists which paragraphs will be included in the independent auditors report?

A)

Introductory	Scope	Opinion	Explanatory
Yes	Yes	Yes	Yes

B)

Introductory	Scope	Opinion	Explanatory
Yes	No	Yes	Yes

C)

Introductory	Scope	Opinion	Explanatory
Yes	No	Yes	No

D)

Introductory	Scope	Opinion	Explanatory
No	No	Yes	No

Answer: B

Terms: Pervasive scope limitation

Diff: Moderate

Objective: LO 3-7

AACSB: Reflective thinking skills

10) What type of audit opinion does the independent auditor issue when the following financial statements are not presented?

A)

Balance Sheet	Income Statement	Statement of Cash Flows
Qualified	Qualified	Qualified

B)

Balance Sheet	Income Statement	Statement of Cash Flows
Disclaimer	Disclaimer	Qualified

C)

Balance Sheet	Income Statement	Statement of Cash Flows
Adverse	Adverse	Adverse

D)

Balance Sheet	Income Statement	Statement of Cash Flows
Adverse	Adverse	Qualified

Answer: D

Terms: Audit opinion issued when financial statements are not presented

Diff: Challenging

Objective: LO 3-7

AACSB: Reflective thinking skills

11) Subsequent to the close of Spacely Sprockets fiscal year ending October 31, 2012, a major debtor has declared bankruptcy due to a series of events. The receivable is significantly material in relation to the financial statements, and recovery is doubtful. The debtor had confirmed the full amount due to Spacely Sprocket at the balance sheet date. Because the account was confirmed at the balance sheet date, Spacely refuses to disclose any information in relation to this subsequent event. The CPA believes that all other accounts were stated fairly at the balance sheet date. In addition, Spacely changed their method of inventory valuation from FIFO to LIFO. This change was disclosed in Note X to the financial statements. Accordingly, what type of opinion should be expressed?

A) Unqualified with an explanatory paragraph.

B) Qualified due to a GAAP departure.

C) Qualified due to a scope limitation.

D) A combination of B and C.

Answer: B

Terms: Audit report when client has subsequent event and change in inventory valuation

Diff: Challenging

Objective: LO 3-7

AACSB: Reflective thinking skills

12) For the report containing a disclaimer for lack of independence, the disclaimer is in the:

- A) third or opinion paragraph.
- B) second or scope paragraph.
- C) first and only paragraph.
- D) fourth or explanatory paragraph.

Answer: C

Terms: Disclaimer in which report paragraph

Diff: Challenging

Objective: LO 3-7

AACSB: Reflective thinking skills

13) When an adverse opinion is issued, a scope paragraph would be:

- A) qualified.
- B) unchanged.
- C) deleted.
- D) expanded to identify the additional procedures which the auditor performed.

Answer: B

Terms: Adverse opinion and scope paragraph

Diff: Challenging

Objective: LO 3-7

AACSB: Reflective thinking skills

14) After the balance sheet date but prior to issuance of the auditor's report the auditor learns that the client's facility in a foreign country has been expropriated. Management refuses to disclose this information in a financial statement footnote or present pro-forma data as to the effect of the event. The auditor should:

- A) add a footnote to the financial statements
- B) disclaim an opinion due to the client imposed scope limitation.
- C) provide the information in the report and modify the opinion.
- D) issue an unqualified opinion but provide the information in the auditor report.

Answer: C

Terms: Material subsequent event management refusal to disclose

Diff: Challenging

Objective: LO 3-1 and LO 3-7

AACSB: Reflective thinking skills

15) The following is a portion of an adverse audit report issued for a public company. (Note: A separate report was issued on the effectiveness of internal control over financial reporting.)

Independent Auditor's Report

To the shareholders of Wallace Corporation

We have audited the accompanying balance sheet of Wallace Corporation as of December 31, 2012, and the related statements of income, retained earnings, and cash flows for the year then ended. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

The company has excluded from property and debt in the accompanying balance sheet certain lease obligations that, in our opinion, should be capitalized in order to conform with generally accepted accounting principles. If these lease obligations were capitalized, property would be increased by \$14,500,000, long-term debt by \$13,200,000, and retained earnings by \$1,300,000 as of December 31, 2012, and net income and earnings per share would be increased by \$1,300,000 and \$2.25, respectively, for the year then ended.

Required:

Complete the above adverse audit report by preparing the opinion paragraph. Do not date or sign the report.

Answer: In our opinion, because of the effects of the matters discussed in the preceding paragraph, the financial statements referred to above do not present fairly, in conformity with generally accepted accounting principles, the financial position of Wallace Corporation as of December 31, 2012, or the results of its operations and its cash flows for the year then ended.

Terms: Adverse audit report

Diff: Challenging

Objective: LO 3-7

AACSB: Analytic skills

Topic: Public

16) The following is a portion of a qualified scope and opinion report due to a scope restriction. (Note: A separate report was issued on the effectiveness of internal control over financial reporting.)

Independent Auditor's Report

To the shareholders of Fast Times Corporation

We have audited the accompanying balance sheet of Fast Times Corporation as of September 30, 2012, and the related statements of income, retained earnings, and cash flows for the year then ended. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

Except as discussed in the following paragraph, we conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

We were unable to obtain audited financial statements supporting the company's investment in a foreign affiliate stated at \$1,040,000, or its equity in earnings of that affiliate of \$501,000, which is included in net income, as described in Note 14 to the financial statements. Because of the nature of the company's records, we were unable to satisfy ourselves as to the carrying value of the investment or the equity in its earnings by means of other auditing procedures.

Required:

Complete the above report by preparing the opinion paragraph. Do not date or sign the report.

Answer: In our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had we been able to examine evidence regarding the foreign affiliate investment and earnings, the financial statements referred to above present fairly, in all material respects, the financial position of Fast Times Corporation as of September 30, 2012, and the results of its operations and its cash flows for the year then ended in conformity with generally accepted accounting principles.

Terms: Qualified scope and opinion report

Diff: Challenging

Objective: LO 3-7

AACSB: Analytic skills

Topic: Public

17) Your CPA firm has completed the fieldwork for the 2012 audit of Sharp Corporation, a private company with an October year-end. You were preparing to draft a standard, unqualified audit report when you discovered that the audit manager on the Sharp engagement owns 10 shares of Sharp's common stock. Prepare the appropriate report.

Answer: We are not independent with respect to Sharp Corporation, and the accompanying balance sheet as of October 31, 2012, and the related statements of income, retained earnings, and cash flows for the year then ended were not audited by us. Accordingly, we do not express an opinion on them.

Note: There is no report title when the auditor issues a disclaimer due to a lack of independence.

Terms: Audit report with lack of independence

Diff: Moderate

Objective: LO 3-7

AACSB: Reflective thinking skills

18) Assume you are the partner in charge of the 2007 audit of Becker Corporation, a private company. The audit report has not yet been prepared. In each independent situation following (1-8), indicate the appropriate action (a-g) to be taken. The possible actions are as follows:

- a. Issue a standard unqualified report.
- b. Qualify both the scope and opinion paragraphs.
- c. Qualify the opinion paragraph.
- d. Issue an unqualified opinion with an explanatory paragraph.
- e. Issue an unqualified opinion with modified wording (no explanatory paragraph).
- f. Issue an adverse opinion.
- g. Disclaim an opinion.

The situations are as follows:

_____ 1. Becker Corporation carries its property, plant, and equipment accounts at current market values. Current market values exceed historical cost by a highly material amount, and the effects are pervasive throughout the financial statements.

_____ 2. Management of Becker Corporation refuses to allow you to observe, or make, any counts of inventory. The recorded book value of inventory is highly material.

_____ 3. You were unable to confirm accounts receivable with Becker's customers. However, because of detailed sales and cash receipts records, you were able to perform reliable alternative audit procedures.

_____ 4. One week before the end of fieldwork, you discover that the audit manager on the Becker engagement owns a material amount of Becker's common stock.

_____ 5. You relied upon another CPA firm to perform part of the audit. Although you were the principal auditor, the other firm audited a material portion of the financial statements. You wish to refer to (but not name) the other firm in your report.

_____ 6. You have substantial doubt about Becker's ability to continue as a going concern.

_____ 7. Becker Corporation changed its method of computing depreciation in 2007. You concur with the change and the change is properly disclosed in the financial statement footnotes.

_____ 8. Ten days after the balance sheet date, one of Becker's buildings was destroyed by a fire. Becker refuses to disclose this information in a footnote to the financial statements, but you believe disclosure is required to conform with GAAP. The amount of the uninsured loss was material, but not highly material.

Answer:

1. f

2. g

3. a

4. g

5. e

6. d or g

7. d

8. c

Terms: Audit reports in various situations

Diff: Challenging

Objective: LO 3-1, LO 2-4, LO 3-5, and LO 3-7

AACSB: Analytic skills

19) Smith and Jones, CPAs, audited the consolidated financial statements of Concord Inc. and all but one of its subsidiaries for the year ended September 30, 2012 and are expressing an unqualified opinion on the financials presented as a whole.

Smith, the engagement partner, instructed Mary, an assistant on the engagement, to draft the auditor's report on November 4, 2012, the date of fieldwork completion. In drafting the report Mary considered the following:

- In preparing its financial statements, Concord changed its method of accounting for research and development costs and properly expensed these amounts. Management described the change in principle in Note 10 to the consolidated financial statements.
- Ball & Brown, CPAs, audited the financial statements of Biotherm, Inc., a consolidated subsidiary of Concord for the year ended September 30, 2012. The subsidiary's financial statements reflect total assets of 22% and total revenues of 20% of the consolidated totals. Ball & Brown expressed an unqualified opinion and furnished to Smith & Jones a copy of their auditor report. Smith & Jones have decided not to assume responsibility for the work of Ball & Brown insofar as it relates to the expression of an opinion on the consolidated financial statements taken as a whole because of the materiality of Biotherm's financial statements to the consolidated whole. Ball & Brown's report will not be presented together with that of Smith & Jones.
- Concord is the subject of a grand jury investigation into possible violations of federal antitrust laws and possible related crimes. Related civil class actions are pending. Concord's management has adequately disclosed in Note 12 to their consolidated financial statements. Because of the early stage of the investigation, the ultimate outcome of these matters cannot be determined at this time. Therefore, no provision for any liability that may result has been recorded.
- Concord experienced a net loss in 2012 and is currently in default under substantially all of its debt agreements. Management's plans in regard to these matters are adequately disclosed in Note 14 to Concord's consolidated financial statements. The financials do not include any adjustments that might result from the outcome of this uncertainty. These matters raise substantial doubt about Concord's ability to continue as a going concern.

Ball reviewed Mary's draft and indicated in his review notes that there were many deficiencies in Mary's Draft. The audit report that Mary drafted follows.

Independent Auditor's Report

We have audited the consolidated financial statements of Concord, Inc., and subsidiaries as of September 30, 2012, and the related consolidated statements of income, changes in stockholders equity and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We did not audit the financial statements of Biotherm, Inc., a wholly-owned subsidiary, which statements reflect total assets and revenues constituting 22% and 20% respectively at September 30, 2011 of the consolidated totals. Those statements were audited by Ball & Brown, CPAs, whose reports have been furnished to us, and our opinion, insofar as it relates to the amounts included for Biotherm, Inc. is based solely on their report.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used, as well as assessing control risk. We believe our audits provide a reasonable basis for our opinion.

In our opinion, based on our audit and the report of the other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Concord Inc., as of September 30, 2012 in conformity with generally accepted accounting principles, except for the uncertainty, which is discussed in Note 12 to the consolidated financials.

The accompanying consolidated financial statements have been prepared assuming that the Company will continue in existence for a reasonable period of time. As discussed in Note 14 to the consolidated financial statements, the Company suffered a net loss and is currently in default under substantially all of its debt agreements. Management's plans in regard to these matters are also described in Note 14. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

Smith & Jones, CPAs
November 4, 2012

Required:

The following items present deficiencies in the drafted audit report noted by Smith. For each deficiency, indicate whether:

- S. Smith's review note is correct
- M. Mary's draft is correct
- B. Both Smith's review note and Mary's draft are incorrect

Smith's Review Notes

1. An explanatory paragraph is required between the scope and opinion paragraphs is required for the change in accounting principles referring the reader to Note 10.
2. The names of the other auditors do not need to be explicitly stated in the introductory paragraph. Only that "other auditors" performed the audit and provided their report.
3. The opinion paragraph should extend the auditor's opinion beyond financial position to include the results of Concord's operations and flows.
4. The reference to the uncertainty in the opinion paragraph is incomplete. It should describe the nature of the uncertainty as pertaining to the grand jury investigation into possible violations of federal antitrust laws.
5. The explanatory paragraph following the opinion paragraph does not include the terms "substantial doubt" and "going concern". These terms are required to be used in this paragraph.
6. The explanatory paragraph following the opinion paragraph includes an inappropriate statement that "the consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty." This statement is misleading and should be omitted.

Answer:

1. B
2. S
3. S
4. B
5. S
6. M

Terms: Deficiencies in audit reports

Diff: Challenging

Objective: LO 3-1, LO 3-4, and LO 3-7

AACSB: Analytic skills

20) In auditing the long-term investments account, Arens, CPA, is unable to obtain audited financial statements for an investee located in a foreign country. Levine concludes sufficient appropriate audit evidence regarding this investment cannot be obtained.

For each of the following situations below, identify the appropriate opinion type and report modification by selecting a choice from the appropriate tables below.

Situation	Opinion Type	Intro	Scope	Opinion	Exp1
1. Assume the potential effect on the financial statements is immaterial.					
2. Assume the potential effect on the financial statements is moderate.					
3. Assume the potential effect on the financial statements is high.					

Opinion Type	Standard Paragraph Choice	Explanatory Paragraph
U Unqualified	O Omit	0 None required
Q Qualified	N No change	+ Insert before opinion
A Adverse	M Modify	- Insert after opinion
D Disclaimer		

Answer:

Situation	Opinion Type	Intro	Scope	Opinion	Exp1
1. Assume the potential effect on the financial statements is immaterial.	U	N	N	N	0
2. Assume the potential effect on the financial statements is moderate.	Q	N	M	M	+
3. Assume the potential effect on the financial statements is high.	D	O	M	M	+

Terms: Circumstances and required audit reports

Diff: Challenging

Objective: LO 3-1, LO 3-4, and LO 3-7

AACSB: Analytic skills

21) Audit situations 1 through 10 present various independent factual situations an auditor might encounter in conducting an audit. List A represents the types of opinions the auditor ordinarily would issue, and List B represents the report modifications (if any) that would be necessary. For each situation, select one response from List A and one from List B. Select, as the best answer for each item, the action the auditor normally would take. Items from either list may be selected once, more than once, or not at all.

Assume the following:

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

Factual Scenario

1. The financial statements present fairly, in all material respects, the financial position, results of operations, and cash flows in conformity with GAAP.
2. In auditing the Long-Term Investments account, an auditor is unable to obtain audited F/S for an investee located in a foreign country. The auditor concludes that sufficient competent evidential matter regarding this investment cannot be obtained but it is not pervasive to the financials as a whole.
3. Due to recurring operating losses and working capital deficiencies the auditor has substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time. However, the F/S disclosures are adequate.
4. The principal auditor decides to refer to the work of another auditor, who audited a wholly owned subsidiary of the entity and issued an unqualified opinion.
5. An entity issues F/S that present financial position and results of operations but omits the related statement of cash flows. Management discloses in the notes to the F/S that it does not believe the statement of cash flows to be useful.
6. An entity changes its depreciation method for production equipment from SL to units of production based on hours of utilization. The auditor concurs with the change, although it has a material effect on the comparability of the entity's F/S.
7. An entity is a defendant in a lawsuit alleging infringement of certain patent rights. However, management cannot reasonably estimate the ultimate outcome of the litigation. The auditor believes that there is a reasonable possibility of a significant material loss, but the lawsuit is adequately disclosed in the notes to the F/S.
8. An entity discloses certain lease obligations in the notes to the F/S. The auditor believes that the failure to capitalize these leases is a departure from GAAP.
9. The entity wishes to show comparative F/S and include the prior year. However, the prior year F/S contained a qualification due to an inappropriate method of GAAP. Accordingly, management corrected the prior year GAAP deficiency and included the updated numbers in the comparative financials for the current year.

10. The entity wishes to show comparative F/S and include the prior year. However, the prior year F/S were audited by another auditor who refuses to reissue his opinion.

List A Opinion Choices	List B Report Modification Choices
A Qualified	H Describe the circumstances in an explanatory paragraph <i>preceding</i> the opinion paragraph w/o modifying the three standard paragraphs.
B Unqualified	I Describe the circumstances in the opinion paragraph w/o adding an explanatory paragraph.
C Adverse	J Describe the circumstances in an explanatory paragraph <i>preceding</i> the opinion paragraph and modify the opinion paragraph.
D Disclaimer	K Describe the circumstances in an explanatory paragraph <i>following</i> the opinion paragraph and modify the opinion paragraph.
E Either Qualified or Adverse	L Describe the circumstances in an explanatory paragraph <i>preceding</i> the opinion paragraph and modify the scope & opinion paragraph.
F Either Disclaimer or Adverse	M Describe the circumstances in an explanatory paragraph <i>following</i> the opinion paragraph and modify the scope & opinion paragraph.
G Either Qualified or Disclaimer	N Describe the circumstances in the scope paragraph w/o adding an explanatory paragraph.
	O Describe the circumstances in an explanatory paragraph <i>following</i> the opinion paragraph w/o modifying the three standard paragraphs.
	P Describe the circumstances in the introductory paragraph w/o adding an explanatory paragraph.
	Q Describe the circumstances in the introductory paragraph w/o adding an explanatory paragraph, and modify the scope & opinion paragraphs.
	R Issue the standard auditor's report w/o modification.
	S None of the above.

Answer:

1. B, R
2. A, L
3. B, I
4. B, Q
5. A, J
6. B, I
7. B, R
8. E, J
9. B, H
10. B, R

Terms: Audit situations and required reports with modifications

Diff: Challenging

Objective: LO 3-1, LO 3-4, LO 3-5, and LO 3-7

AACSB: Analytic skills

22) Financial statement users are typically more concerned with an unqualified report with explanatory paragraphs than they are with a disclaimer of opinion.

- A) True
- B) False

Answer: B

Terms: Financial statement users; Unqualified report with explanatory paragraphs; Disclaimer of opinion

Diff: Moderate

Objective: LO 3-7

AACSB: Reflective thinking skills

23) A lack of independence will override any other scope limitations and requires a disclaimer of opinion.

- A) True
- B) False

Answer: A

Terms: Lack of independence; Disclaimer of opinion

Diff: Moderate

Objective: LO 3-7

AACSB: Reflective thinking skills

24) When a qualified opinion is issued, an explanatory paragraph is added immediately after the opinion paragraph to explain the nature of the qualification that affects the opinion.

- A) True
- B) False

Answer: B

Terms: Qualified opinion explanatory paragraph and opinion paragraph

Diff: Moderate

Objective: LO 3-7

AACSB: Reflective thinking skills

25) If an auditor is not independent and the auditor knows that the company has not followed GAAP, the auditor should immediately disclaim an opinion and not mention the departure from GAAP in the audit report.

- A) True
- B) False

Answer: B

Terms: Auditor not independent, GAAP violations; Disclaim opinion

Diff: Challenging

Objective: LO 3-7

AACSB: Reflective thinking skills

Learning Objective 3-8

1) When a pervasive scope limitation exists, which paragraphs of the independent auditor's report will differ from the standard unqualified audit report?

A)

Introductory	Scope	Opinion	Explanatory
Yes	Yes	Yes	Yes

B)

Introductory	Scope	Opinion	Explanatory
No	Yes	Yes	Yes

C)

Introductory	Scope	Opinion	Explanatory
No	No	Yes	Yes

D)

Introductory	Scope	Opinion	Explanatory
No	No	Yes	No

Answer: A

Terms: Pervasive scope limitation

Diff: Challenging

Objective: LO 3-8

AACSB: Analytic skills

2) Which of the following statements is not true?

- A) A one-paragraph report is generally used when the auditor is not independent.
- B) A three-paragraph report ordinarily indicates there are no exceptions in the audit.
- C) More than three paragraphs in the report indicates there must be some type of qualification in the audit.
- D) An unqualified opinion with an explanation or modified wording would require more than three paragraphs.

Answer: C

Terms: Number of paragraphs in the audit report

Diff: Challenging

Objective: LO 3-8

AACSB: Reflective thinking skills

3) Which auditor report would require only one paragraph?

A)

Disclaimer due to scope restriction	Qualified opinion due to scope restriction
Yes	Yes

B)

Disclaimer due to scope restriction	Qualified opinion due to scope restriction
No	No

C)

Disclaimer due to scope restriction	Qualified opinion due to scope restriction
Yes	No

D)

Disclaimer due to scope restriction	Qualified opinion due to scope restriction
No	Yes

Answer: B

Terms: Auditor report with one paragraph

Diff: Challenging

Objective: LO 3-8

AACSB: Reflective thinking skills

4) A four paragraph auditor opinion is required when:

A)

Unqualified opinion indicating shared responsibility with another auditor	Unqualified opinion expressing substantial doubt that the company is a going concern
Yes	Yes

B)

Unqualified opinion indicating shared responsibility with another auditor	Unqualified opinion expressing substantial doubt that the company is a going concern
No	No

C)

Unqualified opinion indicating shared responsibility with another auditor	Unqualified opinion expressing substantial doubt that the company is a going concern
Yes	No

D)

Unqualified opinion indicating shared responsibility with another auditor	Unqualified opinion expressing substantial doubt that the company is a going concern
No	Yes

Answer: D

Terms: Four paragraph auditor opinion

Diff: Challenging

Objective: LO 3-8

AACSB: Reflective thinking skills

5) A four paragraph auditor opinion is required when:

A)

Qualified opinion due to scope restriction	Disclaimer due to a scope restriction
Yes	Yes

B)

Qualified opinion due to scope restriction	Disclaimer due to a scope restriction
No	No

C)

Qualified opinion due to scope restriction	Disclaimer due to a scope restriction
Yes	No

D)

Qualified opinion due to scope restriction	Disclaimer due to a scope restriction
No	Yes

Answer: C

Terms: Four paragraph auditor opinion

Diff: Challenging

Objective: LO 3-8

AACSB: Reflective thinking skills

6) A four paragraph auditor opinion is required when:

A)

Qualified opinion due to departure from GAAP	Adverse opinion due to departure from GAAP
Yes	Yes

B)

Qualified opinion due to departure from GAAP	Adverse opinion due to departure from GAAP
No	No

C)

Qualified opinion due to departure from GAAP	Adverse opinion due to departure from GAAP
Yes	No

D)

Qualified opinion due to departure from GAAP	Adverse opinion due to departure from GAAP
No	Yes

Answer: A

Terms: Four paragraph auditor opinion

Diff: Challenging

Objective: LO 3-8

AACSB: Reflective thinking skills

7) A four paragraph auditor opinion is required for:

A)

An unjustified accounting change	A justified accounting change, properly accounted for
Yes	Yes

B)

An unjustified accounting change	A justified accounting change, properly accounted for
No	No

C)

An unjustified accounting change	A justified accounting change, properly accounted for
Yes	No

D)

An unjustified accounting change	A justified accounting change, properly accounted for
No	Yes

Answer: C

Terms: Four paragraph auditor opinion

Diff: Challenging

Objective: LO 3-8

AACSB: Reflective thinking skills

8) Any audit report that contains more than three paragraphs means there is either a qualified opinion or required explanation.

A) True

B) False

Answer: A

Terms: Audit report with more than three paragraphs; Qualified opinion or required explanation

Diff: Moderate

Objective: LO 3-8

AACSB: Reflective thinking skills

9) All audit reports with three paragraphs mean the auditor has issued an unqualified opinion.

A) True

B) False

Answer: B

Terms: Audit reports with three paragraphs; Unqualified opinion

Diff: Moderate

Objective: LO 3-8

AACSB: Reflective thinking skills

Learning Objective 3-9

1) Auditing standards of the United States allow auditors to perform an audit in accordance with International Standards on Auditing (ISAs).

A) True

B) False

Answer: A

Terms: Auditing standards of United States and International Standards of Auditing

Diff: Moderate

Objective: LO 3-9

AACSB: Reflective thinking skills