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QUESTION 1

An entity changed from the straight-line method to the declining balance method of depreciation for all newly acquired assets. This change has no material effect on the current year\\'s financial statements, but is reasonably certain to have a substantial effect in later years. If the change is disclosed in the notes to the financial statements, the auditor should issue a report with a(an):

A. "Except for" qualified opinion.

B. Explanatory paragraph.

C. Unqualified opinion.

D. Consistency modification.

Correct Answer: C

Explanation: Choice "c" is correct. If an accounting change has no material effect on the financial statements in the current year, but a material future effect, the auditor must ensure that the change is disclosed in the footnotes whenever the financial statements of the change period are presented, but does not have to recognize the change in the current year\\'s audit report. Choice "a" is incorrect. Accounting changes that are accounted for properly do not result in qualified opinions. Choices "b" and "d" are incorrect. A consistency modification (explanatory paragraph) is not necessary when the effect of a change is immaterial.

QUESTION 2

For a nonissuer, a control deficiency would be considered a material weakness when the likelihood and magnitude of potential financial statement misstatements are:

	Likelihood	*Magnitude*
A.	More than remote	Material
B.	Probable	Material
C.	More than remote	More than inconsequential
D.	Probable	More than inconsequential

A. Option A

B. Option B

C. Option C

D. Option D

Correct Answer: A

Explanation:

Choice "a" is correct. A material weakness is a significant deficiency, or combination of significant

deficiencies, that results in more than a remote likelihood that a material misstatement of the entity\\'s

financial statements will not be prevented or detected.

Choices "b", "c", and "d" are incorrect, based on the above.

QUESTION 3

Capital investments require balancing risk and return. Managers have a responsibility to ensure that the investments that they make in their own firms increase shareholder value. Managers have met that responsibility if the return on the capital investment:

A. Exceeds the rate of return associated with the firm\\'s beta factor.

B. Is less than the rate of return associated with the firm\\'s beta factor.

C. Is greater than the prime rate of return.

D. Is less than the prime rate of return.

Correct Answer: A

Explanation: Choice "a" is correct. A capital investment whose rate of return exceeds the rate of return associated with the firm\\'s beta factor will increase the value of the firm. Choice "b" is incorrect. A capital investment whose rate of return is less than the rate of return associated with the firm\\'s beta factor will decrease the value of the firm. Choice "c" is incorrect. The return on a capital investment in relation to the prime rate of return will not necessarily indicate if the investment increases or decreases the value of the company without knowing the relative risk of the firm in relation to the market and its relationship to the prime rate. Choice "d" is incorrect. The return on a capital investment in relation to the prime rate of return will not necessarily indicate if the investment increases or decreases the value of the company without knowing the relative risk of the firm in relation to the market and its relationship to the prime rate.

QUESTION 4

Which of the following internal control procedures most likely addresses the completeness assertion for inventory?

A. Work in process account is periodically reconciled with subsidiary records.

B. Employees responsible for custody of finished goods do not perform the receiving function.

C. Receiving reports are prenumbered and periodically reconciled.

D. There is a separation of duties between payroll department and inventory accounting personnel.

Correct Answer: C

Explanation:

Choice "c" is correct. The internal control procedure of prenumbering receiving reports and periodically

reconciling them to the inventory records most likely addresses the completeness assertion for inventory,

because it allows the auditor to determine whether all goods received have been recorded as inventory.

Choice "a" is incorrect. Reconciling the work in process account (per the general ledger) with subsidiary records (direct materials, direct labor, overhead) tests that those records are interfacing properly, but does not provide any information about the completeness assertion for inventory.

Choice "b" is incorrect. Separation of employees responsible for custody of finished goods from the receiving function addresses the safeguarding of assets, not the completeness of the inventory records.

Choice "d" is incorrect. The separation of duties between the payroll department and inventory accounting personnel is related to the valuation (pricing) of inventory, not its completeness.

QUESTION 5

Tracing shipping documents to prenumbered sales invoices provides evidence that:

A. No duplicate shipments or billings occurred.

B. Shipments to customers were properly invoiced.

C. All goods ordered by customers were shipped.

D. All prenumbered sales invoices were accounted for.

Correct Answer: B

Explanation:

Choice "b" is correct. By tracing from the shipping documents to the invoices, the auditor confirms that goods that were shipped were properly billed.

Choice "a" is incorrect. Tracing shipping documents to prenumbered invoices would not provide assurance that duplicate shipments or billings did not occur.

Choice "c" is incorrect. In order to test whether all goods that were ordered were shipped, the auditor would trace customer purchase orders to shipping documents.

Choice "d" is incorrect. Determining that all prenumbered sales invoices are accounted for does not require examining shipping documents.

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