

## MULTIPLE CHOICE QUESTIONS FROM BECKER CPA EXAM REVIEW



**3-22 (OBJECTIVES 3-5, 3-7, 3-8)** The following questions concern audit reports other than unmodified opinion audit reports with standard wording. Choose the best response.

- a. As compared to an unmodified opinion, an opinion qualified due to a material departure from generally accepted accounting principles would
  - (1) include an extra paragraph, following the opinion paragraph.
  - (2) indicate that, except for the problem noted, the financial statements are presented fairly.
  - (3) include a slight modification to the introductory paragraph.
  - (4) include a slight modification to the auditor's responsibility paragraph.
- b. An auditor who qualified an opinion because of an insufficiency of audit evidence should refer to the scope limitation in the

	Auditor's Responsibility Paragraph	Opinion Paragraph	Note to the Financial Statements
(1)	Yes	No	Yes
(2)	No	Yes	No
(3)	Yes	Yes	No
(4)	Yes	Yes	Yes

- c. An adverse opinion and a disclaimer of opinion
  - (1) may be used interchangeably.
  - (2) both require modification of the introductory paragraph.
  - (3) result in the auditor's withdrawal from the engagement.
  - (4) indicate situations in which there are material departures from the standards.

## DISCUSSION QUESTIONS AND PROBLEMS

**3-23 (OBJECTIVE 3-1)** A careful reading of an unmodified opinion audit report indicates several important phrases. Explain why each of the following phrases or clauses is used rather than the alternative provided:

- a. "The financial statements referred to above present fairly, in all material respects, the financial position" rather than "The financial statements mentioned above are correctly stated."
- b. "In conformity with accounting principles generally accepted in the United States of America" rather than "are properly stated to represent the true economic conditions."
- c. "In our opinion, the financial statements present fairly" rather than "The financial statements present fairly."
- d. "Brown & Phillips, CPAs (firm name)," rather than "James E. Brown, CPA (individual partner's name)."
- e. "We conducted our audit in accordance with auditing standards generally accepted in the United States of America" rather than "Our audit was performed to detect material misstatements in the financial statements."

**3-24 (OBJECTIVES 3-1, 3-2, 3-4, 3-6, 3-7)** Patel, CPA, has completed the audit of the financial statements of Bellamy Corporation as of and for the year ended December 31, 2016. Patel also audited and reported on the Bellamy financial statements for the prior year. Patel drafted the following report for 2016.

We have audited the balance sheet and statements of income and retained earnings of Bellamy Corporation as of December 31, 2016. We conducted our audit in accordance with generally accepted accounting standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of misstatement.

We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly the financial position of Bellamy Corporation as of December 31, 2016, and the results of its operations for the year then ended in conformity with generally accepted auditing standards, applied on a basis consistent with those of the preceding year.

Patel, CPA  
(Signed)

### Other Information

- Bellamy is a private corporation and is presenting comparative financial statements.
- During 2016, Bellamy acquired Stockard Inc. and the effects of that transaction are reflected in the current year financial statements. Information about this transaction is disclosed in footnote 12.
- Patel was unable to perform normal accounts receivable confirmation procedures for accounts that are material, but not pervasive, to the financial statements. Unfortunately, Patel was not able to perform alternative procedures to support the existence of the receivables.
- Bellamy Corporation is the defendant in litigation where there is a reasonable possibility that Bellamy may be required to pay a substantial amount of cash, which might require the sale of certain fixed assets. Because management does not want to provide any information that the plaintiff might use against Bellamy, the case is not discussed in the financial statements.
- Bellamy issued debentures on January 31, 2015, in the amount of \$10 million. The funds obtained from the issuance were used to finance the expansion of plant facilities. The debenture agreement restricts the payment of future cash dividends to earnings after December 31, 2020. Bellamy has disclosed this in the footnotes to the financial statements.

- a. Identify and explain any items included in "Other Information" that need not be part of the auditor's report. **Required**
- b. Explain the deficiencies in Patel's report as drafted.\*

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

1. Auto Delivery Company has a fleet of several delivery trucks. In the past, Auto Delivery had followed the policy of purchasing all equipment. In the current year, they decided to lease the trucks. The method of accounting for the trucks is therefore changed to lease capitalization. This change in policy is fully disclosed in footnotes.
2. You are auditing Deep Clean Services for the first time. Deep Clean has been in business for several years but over the last two years has struggled to stay afloat given the economic conditions. Based on your audit work, you have substantial doubt that Deep Clean will be in business by the end of its next fiscal year.
3. One of your audit clients has a material investment in a privately held biosciences company. Your audit firm engaged a business valuation specialist to assist in evaluating the client's estimation of the investment's fair value. You conclude that the valuation specialist's work provides sufficient appropriate audit evidence.
4. Four weeks after the year-end date, a major customer of Prince Construction Co. declared bankruptcy. Because the customer had confirmed the balance due to Prince

\* Based on AICPA question paper, American Institute of Certified Public Accountants.

at the balance sheet date, management refuses to charge off the account or otherwise disclose the information. The receivable represents approximately 10% of accounts receivable and 20% of net earnings before taxes.

5. During your audit of Raceway.com, Inc., you conclude that there is a possibility that inventory is materially overstated. The client refuses to allow you to expand the scope of your audit sufficiently to verify whether the balance is actually misstated.
6. You complete the audit of Munich Department Store, and in your opinion, the financial statements are fairly presented. On the last day of the audit, you discover that one of your supervisors assigned to the audit has a material investment in Munich.

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

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



**3-26 (OBJECTIVES 3-4, 3-5, 3-6, 3-7, 3-8)** For the following independent situations, assume that you are the audit partner on the engagement:

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

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

- a. Identify which of the conditions requiring a deviation from a standard unmodified opinion audit report is applicable, if any.
- b. State the level of materiality as immaterial, material, or highly material. If you cannot decide the level of materiality, state the additional information needed to make a decision.

c. Given your answers in parts a. and b., state the appropriate audit report from the following alternatives (if you have not decided on one level of materiality in part b., state the appropriate report for each alternative materiality level):

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

**3-27 (OBJECTIVES 3-4, 3-5, 3-6, 3-7, 3-8)** The following are independent situations for which you will recommend an appropriate audit report:

1. Subsequent to the date of the financial statements as part of his post-balance sheet date audit procedures, a CPA learned that a recent fire caused heavy damage to one of a client's two plants; the loss will not be reimbursed by insurance. The newspapers described the event in detail. The financial statements and footnotes as prepared by the client did not disclose the loss caused by the fire.
2. During the course of his audit of the financial statements of a corporation for the purpose of expressing an opinion on the statements, a CPA is refused permission to inspect the minutes of board of director meetings that document significant decisions of the board. The corporation secretary instead offers to give the CPA a certified copy of all resolutions and actions involving accounting matters.
3. A CPA is engaged in the audit of the financial statements of a large manufacturing company with branch offices in many widely separated cities. The CPA was not able to count the substantial undeposited cash receipts at the close of business on the last day of the fiscal year at all branch offices.

As an alternative to this auditing procedure used to verify the accurate cutoff of cash receipts, the CPA observed that deposits in transit as shown on the year-end bank reconciliation appeared as credits on the bank statement on the first business day of the new year. He was satisfied as to the cutoff of cash receipts by the use of the alternative procedure.

4. On January 2, 2017, the Retail Auto Parts Company received a notice from its primary supplier that effective immediately, all wholesale prices will be increased 10%. On the basis of the notice, Retail Auto Parts revalued its December 31, 2016, inventory to reflect the higher costs. The inventory constituted a material proportion of total assets; however, the effect of the revaluation was material to current assets but not to total assets or net income. The increase in valuation is adequately disclosed in the footnotes.
5. A CPA has completed her audit of the financial statements of a bus company for the year ended December 31, 2016. Prior to 2016, the company depreciated its buses over a 10-year period. During 2016, the company determined that a more realistic estimated life for its buses was 12 years and computed the 2016 depreciation on the basis of the revised estimate. The CPA has satisfied herself that the 12-year life is reasonable. The company has adequately disclosed the change in estimated useful lives of its buses and the effect of the change on 2016 income in a note to the financial statements.
6. E-Lotions.com, Inc., is an online retailer of body lotions and other bath and body supplies. The company records revenues at the time customer orders are placed on the Web site, rather than when the goods are shipped, which is usually 2 days after the order is placed. The auditor determined that the amount of orders placed but not shipped as of the balance sheet date is not material.
7. For the past 5 years, a CPA has audited the financial statements of a manufacturing company. During this period, the audit scope was limited by the client as to the observation of the annual physical inventory. Because the CPA considered the inventories to be material and he was not able to satisfy himself by other auditing procedures, he was unable to express an unmodified opinion on the financial statements in each of the 5 years.

\* Based on AICPA question paper, American Institute of Certified Public Accountants.

The CPA was allowed to observe physical inventories for the current year ended December 31, 2016, because the client's banker would no longer accept the audit reports. However, to minimize audit fees, the client requested that the CPA not extend his audit procedures to the inventory as of the beginning of the year, January 1, 2016.

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

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



**3-28 (OBJECTIVES 3-3, 3-9)** The PCAOB has proposed changes to the auditor's report for public companies that include requirements for the auditor to communicate "critical audit matters." Critical audit matters include those matters during the audit that involved difficult, subjective, or complex auditor judgments or that posed difficulty to the auditor in obtaining sufficient appropriate evidence or in forming the opinion on the financial statements. Similarly, the International Auditing and Assurance Standards Board (IAASB) recently revised the auditor's report in the International Standards on Auditing (ISAs) to require auditors to communicate "key audit matters." Key audit matters include communication of similar kinds of information as proposed by the PCAOB such as areas of higher assessed risk of material misstatement and the effects of significant events or transactions that occurred during the period.

- Required**
- Describe how users of the financial statements may benefit from communications about these matters in an audit report.
  - Describe how communication of these matters may not be beneficial to users of the financial statements.
  - What difficulties, if any, may auditors face in communicating about these matters?



**3-29 (OBJECTIVES 3-1, 3-3, 3-7, 3-9)** The International Auditing and Assurance Standards Board (IAASB) recently revised its standards related to audit reporting. ISA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*, requires the auditor's report to include the following paragraphs under the headings "Basis for Opinion" and "Auditor's Responsibilities for the Audit of the Financial Statements":

#### **Basis for Opinion**

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are independent of the Company in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code) together with the ethical requirements that are relevant to our audit of the financial statements in [the home country] and we have fulfilled our other ethical responsibilities in accordance with these requirements and the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

\* Based on AICPA question paper, American Institute of Certified Public Accountants.

FIGURE 3-1

**Standard Unmodified Opinion Audit Report on Comparative Statements for a U.S. Nonpublic Company—AICPA Auditing Standards**

**ANDERSON and ZINDER, P.C.**  
**Certified Public Accountants**  
**Park Plaza East – Suite 100**  
**Denver, Colorado 80110**  
**303/359-0800**

<b>Report Title</b>	<b>INDEPENDENT AUDITOR'S REPORT</b>
<b>Audit Report Address</b>	To the Board of Directors and Stockholders General Ring Corporation
<b>Introductory Paragraph</b>	We have audited the accompanying balance sheets of General Ring Corporation as of December 31, 2016 and 2015, and the related statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.
<b>Management's Responsibility</b>	<b>Management's Responsibility for the Financial Statements</b> Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.
<b>Auditor's Responsibility</b>	<b>Auditor's Responsibility</b> 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.
<b>Scope paragraph</b>	An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.  We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.
<b>Auditor's Opinion</b>	<b>Opinion</b> In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of General Ring Corporation as of December 31, 2016 and 2015, and the results of their operations and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.
<b>Signature and Address of CPA Firm</b>	<i>Anderson and Zinder, P.C., CPAs</i> Denver, Colorado
<b>Audit Report Date (Date Auditor Has Obtained Sufficient Appropriate Evidence)</b>	February 15, 2017

## Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

Read the preceding paragraphs to answer the following:

Required

- a. How does the information in the preceding paragraphs compare to the information in the paragraphs under the "Auditor's Responsibility" heading in the standard unmodified opinion audit report example for a nonpublic company shown in Figure 3-1 (p. 48)?
- b. How does the information in the preceding paragraphs compare to the information in the scope paragraph in the standard unmodified opinion audit report example for a public company shown in Figure 3-3 (p. 52)?
- c. Discuss whether you believe these paragraphs in the ISA audit report improve auditor communications to users of the financial statements.

**3-30 (OBJECTIVES 3-3, 3-4)** Publicly traded companies must electronically file a variety of forms or reports with the U.S. Securities and Exchange Commission (SEC), including the Form 10-K, which includes the audited annual financial statements. The SEC makes most of these electronic documents available on the Internet via EDGAR, which stands for Electronic Data Gathering, Analysis, and Retrieval system. The primary purpose for EDGAR is to increase the efficiency and fairness of the securities market for the benefit of investors, corporations, and the economy by accelerating the receipt, acceptance, dissemination, and analysis of time-sensitive corporate information filed with the agency.



- a. Visit the SEC Web site ([www.sec.gov](http://www.sec.gov)) and use the link to "Company Filings Search" (under "Filings") to locate the Form 10-K filing for Google, Inc., for the year ended December 31, 2015, to answer the following questions:
  1. Who was Google's auditor?
  2. Did the audit firm issue a combined or separate report(s) on the financial statements and on internal controls over financial reporting?
  3. What type of audit opinion did the auditor provide for the financial statements?
  4. What was the auditor's opinion about internal controls over financial reporting?
  5. What was the report date for the audit report?
- b. Visit the PCAOB's Web site ([www.pcaob.org](http://www.pcaob.org)) and use the link to "Auditing" under the heading for "Standards" to locate the PCAOB's Auditing Standards. Search the links to the Auditing Standards to answer the following questions:
  1. Where would the auditor locate guidance about changes to the auditor's report if Google makes a change in accounting principle that is considered material? Identify the appropriate section in the Auditing Standards and identify the relevant paragraph(s) within that section that would be applicable to this situation. Assume that Google properly reports the change in the financial statements.
  2. Where would the auditor locate guidance to determine the effect on the auditor's report if he or she has substantial doubt about Google's ability to continue as a going concern? Identify the appropriate section and the relevant paragraph(s) within that section that would be applicable to this situation.
  3. Google's Form 10-K contains information that is in addition to the financial statements and related footnotes. Where would the auditor locate guidance that addresses his or her responsibility for this other information and what is the auditor's obligation related to that information? Identify the appropriate section and the relevant paragraph(s) within that section that would be applicable to this situation.

Required

- c. Which of the following is not a provision of the Sarbanes–Oxley Act of 2002?
- (1) The auditor of an issuer may not provide internal audit outsourcing services for the issuer.
  - (2) Audit documentation must be maintained for five years.
  - (3) The lead and reviewing partners must rotate off the audit after five years.
  - (4) Tax services must be preapproved by the audit committee.

## DISCUSSION QUESTIONS AND PROBLEMS



**4-20 (OBJECTIVES 4-1, 4-2)** Newspaper headlines frequently highlight instances where business professionals, politicians, and others are accused of engaging in unethical behavior. In response, there have been numerous attempts to reduce their occurrence. For example, some have argued for universities to include more courses in ethics.

### Required

- a. Describe what constitutes “ethics” and highlight the challenges of developing a set of rules and guidance to increase ethical behavior in society.
- b. Why is ethics important to the conduct of business in a market-based economy?
- c. Why do individuals act unethically?
- d. What are common rationalizations individuals use to justify their unethical behavior?
- e. Discuss whether ethics should be taught, for example, in university courses.

**4-21 (OBJECTIVES 4-5, 4-6)** The following situations involve the provision of nonaudit services. Indicate whether providing the service is a violation of AICPA rules or SEC rules including Sarbanes–Oxley requirements on independence. Explain your answer as necessary.

- a. Providing bookkeeping services to a public company. The services were preapproved by the audit committee of the company.
- b. Providing internal audit services to a public company audit client with the preapproval of the audit committee.
- c. Providing advice to a private company client on accounting for a merger with another private company.
- d. Providing bookkeeping services to a private company. The source documents were prepared and authorized by the client.
- e. Providing internal audit services to a public company that is not an audit client.
- f. Implementing a financial information system designed by management for a private company.
- g. Recommending a tax shelter to a client that is publicly held. The services were preapproved by the audit committee.

**4-22 (OBJECTIVES 4-5, 4-7)** Each of the following situations involves a possible violation of the AICPA Code of Professional Conduct. For each situation, state the applicable rule of conduct and whether it is a violation.

- a. Emrich, CPA, provides tax services, management advisory services, and bookkeeping services and also conducts audits for the same nonpublic client. Because the firm is small, the same person often provides all the services.
- b. Steve Custer, CPA, set up a casualty and fire insurance agency to complement his auditing and tax services. He does not use his own name on anything pertaining to the insurance agency and has a highly competent manager, Jack Long, who runs it. Custer often requests Long to review the adequacy of a client’s insurance with management if it seems underinsured. He believes that he provides a valuable service to clients by informing them when they are underinsured.
- c. Seven small Seattle CPA firms have become involved in an information project by taking part in an interfirm working paper review program. Under the program, each firm designates two partners to review the audit files, including the tax returns and the financial statements, of another CPA firm taking part in the program. At the end of each review, the auditors who prepared the working papers and the reviewers have

a conference to discuss the strengths and weaknesses of the audit. They do not obtain authorization from the audit client before the review takes place.

- d. Franz Marteens is a CPA, but not a partner, with three years of professional experience with Roberts and Batchelor, CPAs. He owns 25 shares of stock in an audit client of the firm, but he does not take part in the audit of the client, and the amount of stock is not material in relation to his total wealth.
- e. A nonaudit client requests assistance of M. Wilkenson, CPA, in the installation of a local area network. Wilkenson has no experience in this type of work and no knowledge of the client's computer system, so he obtains assistance from a computer consultant. The consultant is not in the practice of public accounting, but Wilkenson is confident of his professional skills. Because of the highly technical nature of the work, Wilkenson is not able to review the consultant's work.
- f. In preparing the personal tax returns for a client, Sarah Milsaps, CPA, observed that the deductions for contributions and interest were unusually large. When she asked the client for backup information to support the deductions, she was told, "Ask me no questions, and I will tell you no lies." Milsaps completed the return on the basis of the information acquired from the client.
- g. Roberta Hernandez, CPA, serves as controller of a U.S.-based company that has a significant portion of its operations in several South American countries. Certain government provisions in selected countries require the company to file financial statements based on international standards. Roberta oversees the issuance of the company's financial statements and asserts that the statements are based on international financial accounting standards; however, the standards she uses are not those issued by the International Accounting Standards Board.
- h. Archer Ressler, CPA, stayed longer than he should have at the annual holiday party of Ressler and Associates, CPAs. On his way home he drove through a red light and was stopped by a police officer, who observed that he was intoxicated. In a jury trial, Ressler was found guilty of driving under the influence of alcohol. Because this was not his first offense, he was sentenced to 30 days in jail and his driver's license was revoked for one year.

**4-23 (OBJECTIVES 4-5, 4-7)** Each of the following situations involves possible violations of the AICPA *Code of Professional Conduct*. For each situation, state whether it is a violation of the *Code*. In those cases in which it is a violation, explain the nature of the violation and the rationale for the existing rule.

- a. The audit firm of Miller and Yancy, CPAs, has joined an association of other CPA firms across the country to enhance the types of professional services the firm can provide. Miller and Yancy share resources with other firms in the association, including audit methodologies, audit manuals, and common IT systems for billing and time reporting. One of the partners in Miller and Yancy has a direct financial interest in the audit client of another firm in the association.
- b. Connor Bradley is the partner in charge of the audit of Southern Pinnacle Bank. Bradley is in the process of purchasing a beach condo and has obtained mortgage financing from Southern Pinnacle.
- c. Jennifer Crowe's audit client has a material investment in Porex, Inc. Crowe's nondependent parents also own shares in Porex, and Porex is not an attest client of Crowe's firm. The amount of her parent's ownership in Porex is not significant to Crowe's net worth.
- d. Joe Stokely is a former partner in Bass and Sims, CPAs. Recently, he left the firm to become the chief operating officer of Lacy Foods, Inc., which is an audit client of Bass and Sims. In his new role, Stokely has no responsibilities for financial reporting. Bass and Sims made significant changes to the audit plan for the upcoming audit.
- e. Odonnell Incorporated has struggled financially and has been unable to pay the audit fee to its auditor, Seale and Seale, CPAs, for the 2014 and 2015 audits. Seale and Seale is currently planning the 2016 audit.

- f. Jessica Alma has been serving as the senior auditor on the audit of Carolina BioHealth, Inc. Because of her outstanding work, the head of internal audit at Carolina BioHealth extended her an offer of employment to join the internal audit department as an audit manager. When the discussions with Carolina BioHealth began, Jessica informed her office's managing partner and was removed from the audit engagement.
- g. Morris and Williams, a regional CPA firm, is providing information systems consulting to one of their publicly traded audit clients. They are assisting in the implementation of a new financial reporting system selected by management.
- h. Audrey Glover is a financial analyst in the financial reporting department of Technologies International, a privately held corporation. Audrey was asked to prepare several journal entries for Technologies International related to transactions that have not yet occurred. The entries are reflected in financial statements that the company recently provided to the bank in connection with a loan outstanding due to the bank.
- i. Austin and Houston, CPAs, is performing consulting services to help management of McAlister Global Services streamline its production operations. Austin and Houston structured the fee for this engagement to be a fixed percentage of costs savings that result once the new processes are implemented. Austin and Houston perform no other services for McAlister Global.



**4-24 (OBJECTIVE 4-5)** Marie Janes encounters the following situations in doing the audit of a large auto dealership. Janes is not a partner.

1. The sales manager tells her that there is a sale (at a substantial discount) on new cars that is limited to long-established customers of the dealership. Because her firm has been doing the audit for several years, the sales manager has decided that Janes should also be eligible for the discount.
2. The auto dealership has an executive lunchroom that is available free to employees above a certain level. The controller informs Janes that she can also eat there any time.
3. Janes is invited to and attends the company's annual holiday party. When presents are handed out, she is surprised to find her name included. The present has a value of approximately \$200.

**Required** Use the three-step process in the AICPA conceptual framework to assess whether Janes' independence has been impaired.

- a. Describe how each of the situations might threaten Janes' independence from the auto dealership.
- b. Identify a safeguard that Janes' firm could impose that would eliminate or mitigate the threat of each situation to Janes' independence.
- c. Assuming no safeguards are in place and Janes accepts the offer or gift in each situation, discuss whether she has violated the rules of conduct.
- d. Discuss what Janes should do in each situation.

**4-25 (OBJECTIVE 4-6)** The U.S. national stock exchanges require listed companies to have an independent audit committee.

- Required**
- a. Describe an audit committee.
  - b. What does it mean for the audit committee members to be "independent"?
  - c. What are the typical functions performed by an audit committee?
  - d. Explain how an audit committee can help an auditor be more independent.
  - e. Describe the nature of the audit firm's communications with the audit committee regarding independence issues.
  - f. Some critics of audit committees believe that they bias companies in favor of larger and perhaps more expensive CPA firms. These critics contend that a primary concern of audit committee members is to reduce their exposure to legal liability. The committees will therefore recommend larger, more prestigious CPA firms, even if the cost is somewhat higher, to minimize the potential criticism of selecting an unqualified firm. Evaluate these comments.