

# Auditing and Attestation (AUD)

## AICPA Released Questions - 2022

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# Multiple Choice Question #1:

Under the AICPA Code of Professional Conduct, which of the following tax compliance services performed for an attest client relating to the preparation of a tax return would impair a CPA's independence?

- A. Signing and filing a client's tax return after receiving written authorization from a client employee who reviewed the return and is qualified to sign the return.
- B. Making tax payments from a client's restricted account over which the CPA has signing authority and control.
- C. Filing a client-approved tax return electronically.
- D. Remitting a check payable to a tax authority signed by the client.

Correct Answer: B

## Multiple Choice Question #2:

A registered public accounting firm is conducting an audit of an issuer. Which of the following services may the auditor provide to the client while maintaining independence?

- A. Drafting documents that form the basis of financial statements filed with the SEC.
- B. Originating source data underlying the balance sheet.
- C. Maintaining accounting records.
- D. Preparing an organizational chart of the accounting department.

Correct Answer: D

## Multiple Choice Question #3:

Which of the following items most likely would be included in the engagement letter prepared by an auditor?

- A. Drafts of account confirmations sent to financial institutions.
- B. Meeting dates, attendance, and topics at board of directors' meetings.
- C. Lists of current and previous lawyers retained by the entity.
- D. Services to be provided in addition to the audit.

Correct Answer: D

# Multiple Choice Question #4:

Which of the following is a primary purpose of audit documentation?

- A. To support that the audit was performed in accordance with GAAS.
- B. To prevent legal liability related to the audit performed.
- C. To assure that fraudulent financial reporting did **not** occur.
- D. To maintain professional judgment.

Correct Answer: A

## Multiple Choice Question #5:

Which of the following statements is correct regarding the auditor's responsibility to detect errors and fraud?

- A. The auditor should design and execute an audit that will provide complete assurance that the financial statements are free of material errors or fraud.
- B. The auditor's opinion provides absolute assurance that the financial statements are free of material errors or fraud.
- C. The auditor is **not** responsible for detecting material misstatements resulting from management fraud.
- D. The auditor should design the audit to provide reasonable assurance of detecting errors and fraud that are material to the financial statements.

Correct Answer: D

## Multiple Choice Question #6:

A treasury department overstated its company's cash position by neglecting to account for a \$200,000 wire transfer. Which of the following internal controls could have detected the error?

- A. Performing monthly reconciliations of all bank accounts.
- B. Requiring that all outgoing wire transfers be approved by management.
- C. Requiring internal auditors to perform analytical procedures on cash balances.
- D. Including the daily bank-activity statements as backup to the monthly entries in the cash-receipts journal.

Correct Answer: A



## Multiple Choice Question #7:

In the integrated audit of a nonissuer, in order to obtain evidence to form an opinion on the effectiveness of internal control over financial reporting, an auditor will perform each of the following procedures, **except**

- A. Reviewing misstatements detected during the financial statement audit.
- B. Reviewing tests of controls performed during the financial statements audit.
- C. Reviewing matters related to the entity's capital structure.
- D. Reviewing reports issued during the year by the internal audit department.

Correct Answer: C

## Multiple Choice Question #8:

In which of the following circumstances can an auditor rely on an internal auditor's work?

- A. When there was reliance on the internal audit department in the prior-year's audit.
- B. When the operations are comparable to the prior-year's operations.
- C. When the auditor considers the internal auditors to be objective because they report directly to the corporate controller.
- D. When the auditor can make a positive assessment of the internal audit department's objectivity and competence.

Correct Answer: D

## Multiple Choice Question #9:

An auditor's responsibility for a client entity's compliance with laws and regulations impacting the entity is to

- A. Prevent noncompliance with applicable laws and regulations.
- B. Ensure that operations are conducted in accordance with laws and regulations.
- C. Detect any noncompliance with applicable laws and regulations.
- D. Identify material misstatements in the entity's financial statements due to noncompliance with applicable laws and regulations.

Correct Answer: D

## Multiple Choice Question #10:

With regard to the performance of audit sampling during the audit of a nonissuer client, which of the following statements is correct?

- A. Professional judgment is **not** a valid justification in deciding whether to use a statistical or nonstatistical sampling approach.
- B. Sample size is a valid criterion in deciding between a statistical or nonstatistical sampling approach.
- C. The level of sampling risk that the auditor is willing to accept affects the sample size.
- D. The sampling unit must be stated in monetary terms.

Correct Answer: C

# Multiple Choice Question #11:

Which of the following auditing procedures would provide the best audit evidence in testing the existence of the accounts receivable balance?

- A. Obtaining confirmation of receivables directly from customers.
- B. Tracing sales register selections into the accounts receivable listing.
- C. Obtaining a management representation letter regarding accounts receivable.
- D. Testing shipping cutoff procedures.

Correct Answer: A

## Multiple Choice Question #12:

For which of the following responses in a legal letter would an auditor most likely qualify the audit opinion for a scope limitation?

- A. The response is limited to only those items that the attorney has devoted substantial attention.
- B. The attorney is unable to respond as to the outcome of the matter because of inherent uncertainty.
- C. The response specifically excludes information on a pending legal matter because of publicity concerns.
- D. The attorney is unable to provide a reasonable estimate of a probable loss arising from a legal matter.

Correct Answer: C

## Multiple Choice Question #13:

In an audit of a nonissuer, each of the following factors may raise substantial doubt about the nonissuer's ability to continue as a going concern for a reasonable period of time, **except**

- A. Internal work stoppages.
- B. Negative financial trends.
- C. Underinsured catastrophe coverage.
- D. Plans to dispose of fully depreciated assets.

Correct Answer: D

## Multiple Choice Question #14:

Which of the following is the principal reason for the requirement to obtain a management representation letter from client management?

- A. To reduce reliance on employee-completed internal control questionnaires.
- B. To reduce reliance on analytical procedures that have been performed.
- C. To replace assertions in the legal representation letter.
- D. To complement other auditing procedures that have been performed.

Correct Answer: D



## Multiple Choice Question #15:

Which of the following procedures would **least** likely help the auditor discover a subsequent event at the conclusion of the audit?

- A. Reviewing and analyzing the latest available interim financial statements.
- B. Reviewing the minutes of meetings with board of directors.
- C. Reviewing the audit working papers.
- D. Obtaining a legal letter from the client's attorney.

Correct Answer: C

## Multiple Choice Question #16:

In an audit of an issuer's financial statements, the auditor determined that there was substantial doubt about the issuer's ability to continue as a going concern for a reasonable period of time. If there were **no** other significant audit findings, which of the following indicates the proper form of the audit report that should be issued?

- A. A disclaimer of opinion.
- B. An adverse opinion with an other-matter paragraph.
- C. An unqualified opinion with an explanatory paragraph.
- D. A qualified opinion with an emphasis-of-matter paragraph.

Correct Answer: C

## Multiple Choice Question #17:

If an accountant compiles financial statements for an entity and a member of the engagement team has a direct financial interest in the entity, then the accountant should

- A. Issue a report for the preparation of client financial statements.
- B. Indicate the accountant's lack of independence in a final paragraph of the compilation report.
- C. Include a statement on each page of the financial statements that the accountant is **not** independent.
- D. Disclose in the notes to the financial statements a description of the reason the accountant's independence is impaired.

Correct Answer: B

## Multiple Choice Question #18:

If an auditor is reporting on financial statements of a nonissuer prepared in accordance with a financial reporting framework generally accepted in a country other than the United States and the auditor uses the other country's report form and content for use only outside the United States, then the auditor should

- A. Issue a similar United States form of the report to only those parties specified by the audit client.
- B. Include an other-matter paragraph in the audit report identifying the significant differences between the reporting framework of the other country and the reporting framework of the United States.
- C. Obtain approval of the comparable United States regulatory authority prior to issuing the report in the form and content of the other country.
- D. Comply with the reporting standards of the other country and identify the other country in the report.

Correct Answer: D

## Multiple Choice Question #19:

Which of the following terms used in the *Statements on Auditing Standards* indicates a presumptively mandatory requirement?

- A. Must.
- B. Should.
- C. Could.
- D. Consider.

Correct Answer: B

## Multiple Choice Question #20:

In which of the following circumstances is a registered public accounting firm's independence impaired with respect to an issuer?

- A. The firm is a member of a trade association that is an audit client.
- B. The firm's affiliate provides tax advisory services to a member of the board of directors of the issuer.
- C. The firm recommends a human resources software system to the issuer and receives a commission from the software vendor.
- D. The firm advises the issuer on the tax consequences of alternative ways of structuring a transaction after receiving approval of the audit committee.

Correct Answer: C

## Multiple Choice Question #21:

For an engagement to prepare financial statements, which of the following items should be identified in the engagement letter as management's responsibility?

- A. The preparation of financial statement disclosures.
- B. The determination of the level of assurance over the financial statements.
- C. The accuracy of significant judgments to be used in the preparation of the financial statements.
- D. The inclusion of the financial reporting framework description on the face of the financial statements.

Correct Answer: C

## Multiple Choice Question #22:

If an audit firm determines that a quality control review is required, but it has **not** yet been performed, what should an audit engagement partner do?

- A. Issue an unqualified audit report with an explanatory paragraph.
- B. Refrain from issuing the audit report until after the quality control review has been completed.
- C. Issue a qualified audit report with an explanatory paragraph.
- D. Request that the audit engagement team members perform the quality control review in a timely manner.

Correct Answer: B



## Multiple Choice Question #23:

Which of the following accounts would an auditor most likely test prior to the balance sheet date?

- A. Interest receivable.
- B. Accrued liabilities.
- C. Short-term debt.
- D. Maintenance and repairs expense.

Correct Answer: D

## Multiple Choice Question #24:

An auditor was testing whether shipments were made only to credit-worthy customers. The client informed the auditor that the information technology system would not print bills of lading for customers that were on credit hold. The auditor would most likely next perform which of the following?

- A. Select a sample of customers on credit hold, attempt to print bills of lading for these customers, and verify with the information technology department that only a few customers are on credit hold.
- B. Attempt to print a bill of lading for one customer on credit hold and verify with the information technology department that this control **cannot** be overridden without approval.
- C. Review recent shipments for a sample of customers on credit hold and verify with the accounting manager that all shipments were shipped by the due date.
- D. Review the customer files for the names of all customers on credit hold and verify with the accounting manager that **no** shipments were made to these customers after they were listed on credit hold.

Correct Answer: B

## Multiple Choice Question #25:

Which of the following statements is correct with respect to the testing of controls in an audit of an issuer's financial statements?

- A. An auditor should assess control risk at **less** than the maximum for all relevant assertions.
- B. An auditor must obtain evidence that controls are operating effectively during the entire period of reliance if the auditor plans to assess control risk at **less** than the maximum.
- C. The evidence necessary to support an auditor's control risk assessment usually does **not** depend on the degree of reliance the auditor plans to place on the effectiveness of a control.
- D. Tests of controls are **not** required to be performed on assertions for which substantive procedures alone provide insufficient audit evidence.

Correct Answer: B

## Multiple Choice Question #26:

An auditor determined materiality for planning purposes before year end based on a nonissuer entity's prior-year financial statements. During the audit, the auditor learns that the actual financial results are significantly different from those of the prior year because of a merger. The auditor's most appropriate response would be to

- A. Reassess the risk of material misstatement to determine whether detection risk remains appropriate.
- B. Revise materiality for the financial statements as a whole.
- C. Reperform audit procedures completed before year end.
- D. Reevaluate the sufficiency of audit procedures performed in the prior-year audit.

Correct Answer: B

## Multiple Choice Question #27:

Which of the following statements is correct with regard to the consideration of materiality when an auditor is planning and performing a financial statement audit of an issuer?

- A. When determining a tolerable misstatement threshold, an auditor should take into account the amount of misstatements that were accumulated in prior periods.
- B. An auditor should determine a tolerable misstatement threshold at the overall financial statement level, but **not** at the account or disclosure level.
- C. An auditor does **not** need to express materiality as a specified, quantitative amount.
- D. When the reevaluation of materiality results in a significantly lower amount than initially established, an auditor would generally **not** modify audit procedures.

Correct Answer: A

## Multiple Choice Question #28:

In an audit of a nonissuer's defined benefit pension plan, which of the following procedures most effectively tests that benefit payments to plan participants are paid in accordance with the plan document?

- A. Recalculating benefits for selected participants based on the plan provisions using relevant service and salary history to support the recorded benefits paid to the participants.
- B. Inquiring of the plan administrator about the internal control procedures in place to ensure that the benefit payments to plan participants are paid in accordance with the plan provisions.
- C. Sending confirmations to plan participants to ascertain that the amount paid to them in the fiscal year is the same as recorded in the general ledger account related to benefit payments.
- D. Testing the accuracy and completeness of benefit payments made to plan participants and comparing the benefit payments recorded in the general ledger to the benefit payment records in participant records.

Correct Answer: A

## Multiple Choice Question #29:

From which of the following populations most likely would a sample be drawn by an auditor who is confirming accounts receivable as of June 30?

- A. Bills of lading for goods shipping prior to June 30.
- B. Customer payments received subsequent to June 30.
- C. The accounts receivable detail listing as of June 30.
- D. Customer sales agreements signed subsequent to June 30.

Correct Answer: C

## Multiple Choice Question #30:

An auditor is in the process of identifying any pending litigation claims against the client that might require disclosure in the audited financial statements. Which of the following steps should the auditor take first to acquire information regarding litigation?

- A. Request that management mail a letter of inquiry to the client's legal counsel.
- B. Inquire about and discuss any potential litigation with management.
- C. Send a letter of inquiry to the client's legal counsel.
- D. Examine contracts for potential violations.

Correct Answer: B



## Multiple Choice Question #31:

Which of the following factors would most likely raise substantial doubt about a nonissuer's ability to continue as a going concern?

- A. The bankruptcy of the nonissuer's primary supplier as a result of declining margins and performance in the industry.
- B. A loss of key management personnel in accordance with the succession plan instituted by those charged with governance.
- C. A substantial decline in net income as a result of one-time charges for obsolete inventory in an otherwise profitable reporting unit.
- D. The modification of an outstanding bank note that results in an impending balloon payment being refinanced and paid over a period of 10 years.

Correct Answer: A

## Multiple Choice Question #32:

An auditor's evaluation of uncorrected misstatements for an audit of an issuer should include evaluation of the effects of uncorrected misstatements detected in

- A. The prior years and misstatements detected in the current year that relate to prior years.
- B. The current year that relates to prior years, but **not** misstatements detected in prior years.
- C. The prior years, but **not** misstatements detected in the current year, that relate to prior years.
- D. The prior years or misstatements detected in the current year that relate to prior years, but **not** both.

Correct Answer: A

## Multiple Choice Question #33:

Which of the following procedures would most likely help an auditor identify events after the date of the financial statements that should be disclosed?

- A. Review changes in the interest rate for cash accounts.
- B. Follow up on accounts receivable confirmations that were **not** returned for additional loss accruals.
- C. Inquire about changes in capital stock that was issued or repurchased.
- D. Evaluate depreciation schedules for additional depreciation expense.

Correct Answer: C

## Multiple Choice Question #34:

During an engagement to prepare financial statements, an accountant was precluded by management from including a statement on each page of the financial statements indicating that **no** assurance is provided. Which of the following actions would be appropriate?

- A. Issue an adverse opinion on the financial statements.
- B. Issue a disclaimer making clear that **no** assurance is provided.
- C. Limit the distribution of the financial statements to specific users.
- D. Perform sufficient procedures to allow the accountant to provide limited assurance on the financial statements.

Correct Answer: B

## Multiple Choice Question #35:

A nonissuer changes from an accounting principle not in accordance with the applicable reporting framework to an accounting principle in accordance with the applicable reporting framework. How should the auditor characterize such a change?

- A. As a change in reporting entity.
- B. As a change in accounting principle.
- C. As a correction of a misstatement.
- D. As a change in classification.

Correct Answer: C

## Multiple Choice Question #36:

If a U.S. auditor is reporting on financial statements of a nonissuer prepared in accordance with a financial reporting framework generally accepted in another country and intended for use only outside the U.S., then the auditor

- A. Is required to use the report form and content of the other country provided that, in similar circumstances, such a report would be issued by auditors in that country.
- B. Should report using either a U.S. form of report or the report form and content of the other country as long as the requirements for that report have been met.
- C. Must issue both a report in the form and content of the other country and a modified U.S. form of report stating that the financial statements are **not** prepared in accordance with U.S. GAAS.
- D. Is required to use a U.S. form of report stating that the financial statements being reported on have been prepared in accordance with the financial reporting framework accepted in another country.

Correct Answer: B

# Simulation #1:







**Scroll down to complete all parts of this task.**

FlintaTea, Inc. is a mid-sized manufacturing company. The company uses separate fixed asset and general ledger systems.

The auditors of FlintaTea received the flowchart located in the exhibit above. The flowchart outlines the fixed asset requisition, receipt, and financial closing processes for depreciable assets. The company's policy is to capitalize all assets over \$500.

For each of the numbered control points in the flowchart listed in the table below, click in the associated cell, and select from the option list provided the most appropriate control to mitigate risk at that point in the process.

An option may be used once or not at all.

Process	Control
1	Requesting employee's manager approves requisition in purchase program in accordance with company's documented policy. 
2	Receiving department prepares the receiving report, inspects the shipment, and matches shipping documentation to purchase order. 
3	Fixed asset accountant records asset in the fixed asset subsidiary ledger based on asset number and type, upon approval by the fixed asset manager. 
4	Accounting department prepares monthly entry based on fixed asset subsidiary ledger, and obtains approval by the controller. 
5	Fixed asset manager prepares evaluation of impairment for approval by controller. 
6	Accounting department prepares reconciliation of subsidiary ledger to general ledger, which is approved by the controller. 

-- Option List Details --

Process 1 List

- Fixed asset manager prepares a report of all fixed asset additions and forwards it to the controller for approval monthly.
- Requesting employee approves requisition in purchase program in accordance with company's documented policy.
- Requesting employee's manager approves requisition in purchase program in accordance with company's documented policy.
- System automatically approves and forwards request to accounts payable.
- System automatically sends requisition to accounts payable for approval.

Process 2 List

- Fixed asset accountant receives, inspects, and records the shipment.
- Purchasing department inspects the shipment and forwards the goods to the fixed asset department for recording.
- Purchasing department inspects the shipment and matches the shipment to the approved purchase order.
- Receiving department accepts and forwards the shipment to the fixed asset department.
- Receiving department prepares the receiving report, inspects the shipment, and matches shipping documentation to purchase order.

Process 3 List

- Accounts payable records the transaction in the general ledger, which is then approved by the accounts payable manager.
- Fixed asset accountant records asset in the fixed asset subsidiary ledger based on asset number and type, upon approval by the fixed asset manager.
- Purchasing department records the fixed asset in the fixed asset subsidiary based on the purchase requisition, which is then approved by the accounts payable manager.
- Receiving department records the fixed asset in the fixed asset subsidiary ledger based on asset number and type, which is then approved by the receiving manager.
- Receiving department records the fixed asset in the general ledger based on the purchase acquisition, which is then approved by the purchasing manager.



#### Process 4 List

- Accounting department prepares monthly entry based on fixed asset subsidiary ledger, and obtains approval by the controller.
- Controller prepares and records the monthly depreciation entry.
- Fixed asset accountant establishes monthly recurring entry.
- Fixed asset manager prepares monthly entry based on general ledger, and posts entry to subsidiary ledger.
- Manager for each department in which fixed assets are used, records a monthly depreciation entry based on professional judgment.

#### Process 5 List

- Controller prepares impairment evaluation based on input from department managers.
- Fixed asset manager prepares evaluation of impairment for approval by controller.
- Fixed asset manager prepares impairment evaluation for approval by manager of department in which fixed assets are used.
- Manager for each department prepares impairment evaluation based on professional judgment.
- Receiving manager reviews and approves impairment evaluation prepared by fixed asset manager.

#### Process 6 List

- Accounting department prepares reconciliation of subsidiary ledger to general ledger, which is approved by the controller.
- Accounts payable accountant prepares reconciliation between fixed asset subsidiary ledger and accounts payable subsidiary ledger; reconciliation is approved by the fixed asset manager.
- Controller reconciles purchase orders to fixed asset subsidiary ledger.
- Fixed asset manager prepares reconciliation of fixed asset subsidiary detail report to the fixed asset subsidiary summary report, which is approved by the fixed asset accountant.
- Fixed asset manager prepares reconciliation of fixed asset subsidiary ledger to the general ledger.

END OF CONTENT -----

## *Exhibits Information*

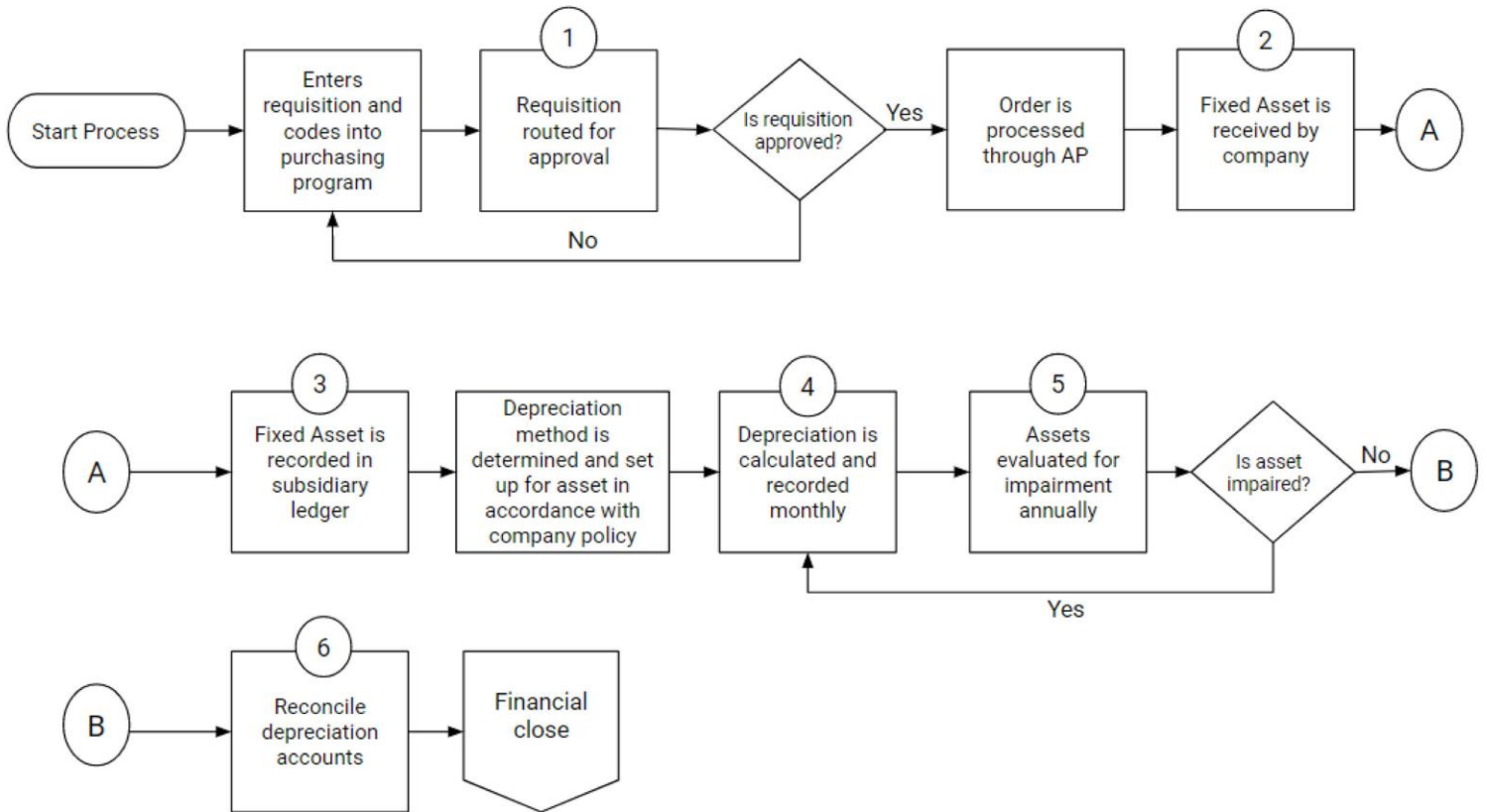
Exhibits included in this item

1. Flowchart - Read Only

Exhibit 1: Flowchart - Read Only

The following flowchart obtained by the company's auditors documents the company's fixed assets process. Control points are indicated by numbered circles.

**Fixed Assets-Additions and Recording**



## *Blueprint Information*

CSO: 002.003.002






Skill: Analysis

Representative task: Identify and document the relevant manual controls within the flow of an entity's transactions for a significant business process and consider the effects of these controls on the completeness, accuracy and reliability of an entity's data.






# Simulation #2:

Scroll down to complete all parts of this task.

For the audit objectives for accounts receivable below, select from the option list the best audit procedure that corresponds to the objective. An option may be used once, more than once, or not at all.

Audit objectives for accounts receivable	Audit procedure
Accounts receivable at the balance sheet date were actually owed to the company.	Obtain positive confirmations of a sample of the accounts receivable as of the balance sheet date. 
Accounts receivable represents all amounts owed to the entity at the balance sheet date.	Perform sales cutoff tests to obtain assurance that sales transactions are recorded in the proper period. 
The entity has a legal right to all accounts receivable at the balance sheet date.	Review loan agreements for indications of whether accounts receivable have been factored or pledged. 
Accounts receivable are stated at net realizable value.	Review the aged trial balance for significant past due accounts. 
Trade accounts receivable are properly described and presented in the financial statements.	Review the accounts receivable trial balance for amounts due from officers and employees. 

MO 2 Key 2

Audit objectives for accounts receivable	Audit procedure
Accounts receivable at the balance sheet date were actually owed to the company.	
Accounts receivable represents all amounts owed to the entity at the balance sheet date.	Review the master shipping file for shipments made, but not recorded. 
The entity has a legal right to all accounts receivable at the balance sheet date.	
Accounts receivable are stated at net realizable value.	
Trade accounts receivable are properly described and presented in the financial statements.	

-- Option List Details --

- Analyze the relationship of accounts receivable and sales and compare it with relationships for preceding periods.
- Analyze unusual relationships between monthly accounts receivable balances and monthly accounts payable balances.
- Obtain positive confirmations of a sample of the accounts receivable as of the balance sheet date.
- Perform sales cutoff tests to obtain assurance that sales transactions are recorded in the proper period.
- Review loan agreements for indications of whether accounts receivable have been factored or pledged.
- Review the accounts receivable trial balance for amounts due from officers and employees.
- Review the aged trial balance for significant past due accounts.
- Review the master shipping file for shipments made, but not recorded.

## *Exhibits Information*

*There are no exhibits for this item.*

## *Blueprint Information*

CSO: 002.005.003

Skill: Application

Representative task: Develop planned audit procedures that are responsive to identified risks of material misstatement due to fraud or error at the relevant assertion level for significant classes of the transactions and account balances.



# Simulation #3:

An auditor has concluded that action should be taken to prevent future reliance on the audit report as a result of the subsequent discovery of facts that existed at the report date. The auditor concluded that the facts could mislead potential investors, and the nonissuer client has refused to make the appropriate disclosures. What section of the authoritative literature outlines the steps the auditor may take to prevent future reliance upon the audit report?

Enter your response in the answer fields below. Guidance on correctly structuring your response appears above and below the answer fields.

Type the paragraph here.

*Correctly formatted AU-C paragraphs are 1, 2, or 3 digits, preceded in some cases by an upper case letter.*

AU-C  ·

**i** Some examples of correctly formatted AU-C responses are AU-C§123.45, AU-C§123.456, AU-C§123.A45, AU-C§123.A456, AU-C§1234.56, AU -C§1234.567

END OF CONTENT -----

## *Exhibits Information*

*There are no exhibits for this item.*

## *Blueprint Information*

CSO: 003.007.000

Skill: Application

Representative task: AU-C 560.A24

# Simulation #4:




**Scroll down to complete all parts of these tasks.**

A CPA firm is completing the December 31, year 10, audit of ABC Manufacturing Co., a nonissuer.

The audit team met with management and discussed significant matters related to year 10. Notes from that discussion are documented in an exhibit above. Use the exhibits above to complete the two tasks below. All amounts are considered material.

## **Task 1:**

Review the evidence in the exhibits above to determine whether the audit evidence obtained by the audit team is sufficient and appropriate, and determine whether any additional audit procedure is required. For each matter identified below, select from the option list the additional audit procedure required, if any. If no additional audit procedure is required, select "No further audit procedure is required."

<b>Matter to evaluate</b>	<b>Additional audit procedure required, if any</b>
Concrete Specialties walkway replacement	No further audit procedure is required. 
Hudson, Inc. litigation	Send a letter of inquiry to ABC Manufacturing Co.'s external legal counsel. 
Pluto Bank loan modification	No further audit procedure is required. 

-- Option List Details --

List B2

- Determine whether the company followed competitive bidding procedures in selecting the contractor.
- Inspect the walkways to ensure that the repairs were made as specified.
- Recalculate the current-year depreciation expense for the walkway replacement.
- Test the operating effectiveness of internal controls related to accounts payable and cash disbursements.
- No further audit procedure is required.

List B3

- Analytically review legal expenses between the prior year and the current year.
- Independently determine the probability that ABC Manufacturing will not prevail by researching similar lawsuits in the industry.
- Inquire regarding the accounting treatment of the loss contingency with the in-house legal counsel of ABC Manufacturing Co.
- Send a letter of inquiry to ABC Manufacturing Co.'s external legal counsel.
- No further audit procedure is required.

List B4

- Ensure that management includes a statement that the debt covenant violation will be remediated in the management representation letter.
- Obtain the December 31, year 10, debt covenant violation waiver.
- Test the operating effectiveness of internal controls over loans payable.
- Vouch payments made on the Pluto loan during year 10.
- No further audit procedure is required.










**Task 2:**

Prepare the year 10 adjusting journal entries, if necessary, to propose to ABC's management for each matter in Task 1. Assume that any additional audit procedures identified above were completed without exception.

To prepare each required journal entry:

- Click on a cell in the Account Name column and select the appropriate account. An account may be used once or not at all for a journal entry.
- Enter the corresponding debit or credit amount in the associated column.
- All amounts will be automatically rounded to the nearest dollar.
- Not all rows in the table might be needed to complete each journal entry.
- If no journal entry is needed, check the "No entry required" box at the top of the table as your response.

Concrete Specialties walkway replacement:

<input type="checkbox"/> No Entry Required		
Account Name	Debit	Credit
Prepaid expenses and deposits 	3,000 	
Repairs and maintenance expense 		3,000 
		

Select an option below

- Accounts payable
- Accrued expenses
- Accumulated depreciation
- Cash
- Depreciation expense
- Land improvements
- Prepaid expenses and deposits
- Repairs and maintenance expense



Pluto Bank loan modification:

<input type="checkbox"/> No Entry Required		
Account Name	Debit	Credit
Loan payable - long-term	150,000	
Loan payable - current		150,000

Select an option below

- Accrued expenses
- Credit loss expense
- Interest expense
- Gain/loss on extinguishment of debt
- Loan payable - current
- Loan payable - long-term
- Non-operating cash

RESET      CANCEL      ACCEPT

END OF CONTENT -----



## *Exhibits Information*

Exhibits included in  
this item

- 1. Discussion with Management**
- 2. Proposal from Concrete Specialties**
- 3. Email from Concrete Specialties**
- 4. Check Request Form - Concrete Specialties**
- 5. Pluto Bank Notification**

## Exhibit 1: Discussion with Management

### Discussion with Management

#### ABC Manufacturing Company

On January 15, year 11, the audit team met with management to discuss significant matters related to the year ended December 31, year 10.

#### Discussion Notes:

Concrete Specialties walkway replacement: Temporary repairs were made to the walkways in December, year 10. Examination indicated that repairing the walkways would be insufficient in the long term; therefore, a replacement is necessary. The replacement will begin in March, year 11, and the balance of the December deposit will be applied toward the new walkway.

Hudson, Inc. litigation: Hudson, Inc., a competitor, filed a patent infringement claim against ABC in year 10. Hudson alleges that the company's manufacture and sale of its products infringed on Hudson's Patent No. 7589462 and is seeking monetary relief. ABC has been advised by their external legal counsel, Ginger & Orange LLP, that it is not probable that ABC Manufacturing will prevail. The legal counsel also advised that while it is not possible to determine a specific amount of damages, the range of loss is estimated to be between \$400,000 and \$600,000, and no amount within the range is a better estimate than any other amount. Accordingly, based on this advice, ABC has accrued \$400,000 as a provision for this lawsuit.

Pluto Bank loan modification: As a result of failing to comply with debt covenants over the last three quarters of year 10, ABC was notified by Pluto Bank that it will not grant a waiver of the debt covenant violation at year end, and the outstanding loan balance will be called. As such, the total principal amount of \$215,000 will be due in full on April 1, year 11. The company will use excess non-operating cash to pay off the loan.

**Proposal**

**January 8, year 11**

**Concrete Specialties  
444 Wood Avenue  
Anytown, NJ 08628**

**To:**

ABC Manufacturing Company  
789 Third Avenue  
Anytown, NJ 08628  
Contact Name: Chuck M.

**Work to be Performed:**

- Removal of existing walkways connecting the front entrance to the parking lot.
- Widen walkways by 12" and install ramps at corners, using non-slip inserts.

**Total Price: \$20,200**

**Work to begin on or about March 1, year 11**

**Expected completion date March 20, year 11**

**Expected Payment Schedule:**

- Deposit applied (see below);
- \$8,600 when work begins (50%);
- Remainder after completion and inspection.

	<b>Amount</b>
<b>Total price</b>	\$20,200
Payment: Deposit Applied, check #11590 December 5, year 10	(\$3,000)
Remaining balance	\$17,200

**Proposal and Payment Terms Accepted**

**Name:** Chuck M

**Title:** Facilities Manager

**Date:** January 10, year 11

Exhibit 3: Email from Concrete Specialties

*Provided by Client*

**From:** John T. <engineering@concretespecialties.com>  
**To:** Chuck M. <chuck@ABC.com>  
**Date:** December 20, year 10 12:09pm  
**Subject:** Walkway Repairs

Dear Chuck:

This is to confirm the discussion we had at your site last week.

Upon making a closer examination of the repairs needed to the walkways, you agreed that the extent of the repairs that would be needed was greater than originally expected. We made temporary repairs to the walkways immediately so that there are no safety issues. However, because of underlying issues, it was agreed that ABC Manufacturing will need to replace the walkways to comply with current building code requirements.

The cost for the temporary repairs came to \$2,700, which will be deducted from the \$5,700 check we received from ABC Manufacturing on December 5, year 10. Per your instructions, the remaining balance from the original payment will be held and applied toward the replacement of the walkways.

We will provide a proposal for the additional work required within the next 30 days. Once you have reviewed and agreed to the proposal, please sign the copy provided and return it to us. Work will begin on replacing the walkways once the threat of frost has passed.

Sincerely,

*John T.*  
Engineering Department  
engineering@concretespecialties.com

## **Check Request Form**

**Amount: \$5,700 T**

**Payee:**

Concrete Specialties  
444 Wood Avenue  
Anytown, NJ 08628  
Phone (973) 555-1800

**Requested by:**

Chuck M.  
Chuck M., Facilities Manager

**Reason for Request:**

Check required to accompany the signed contract for walkway repairs. Work is expected to begin December 15, year 10.

**G/L Account:**

5598 - Repairs and maintenance expense

**Paid:**

Check # 11590, December 5, year 10  
Nancy B., Bookkeeper

**T** - Traced to General Ledger account 5598 and bank statement as of December 31, year 10.

Exhibit 5: Pluto Bank Notification

**PLUTO BANK**

10011 First Street  
Anytown, NJ 08628

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**February 13, year 11**

**ABC Manufacturing Company**

**789 Third Avenue**

**Anytown, NJ 08628**

Loan Number: 17-1639946

Loan Balance as of 12-31-year 10: \$215,000 **T, C**

Please be advised that the above-mentioned loan will be due in full on April 1, year 11.

REASON: Code 98.1 - Violation of debt covenant

You will receive further details from the Commercial Loan Department within the next 30 days.

COMMERCIAL LOAN DEPARTMENT

Note: This document was obtained directly by the bank

**T** - traced to December 31, year 10, unadjusted trial balance as follows:

Loan Payable - current:	65,000
Loan Payable - long-term:	<u>150,000</u>
	215,000

**C** - ties to loan confirmation dated December 31, year 10

## *Blueprint Information*

CSO: 003.001.000

Skill: Evaluation

Representative task: Evaluate whether sufficient appropriate evidence has been obtained to achieve the objectives of the planned procedures.