

Name _____

MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.

- 1) In the audit of historical financial statements by PA firms, the criteria used are 1) _____
- A) regulations of the provincial securities commissions.
 - B) generally accepted accounting principles.
 - C) regulations of the Canada Revenue Agency.
 - D) generally accepted auditing standards.

Answer: B

- 2) Auditing should be done by 2) _____
- A) a professional accountant.
 - B) a chartered accountant.
 - C) a competent and independent person.
 - D) a certified management accountant.

Answer: C

- 3) A large PA firm has assessed evidence collected during an engagement. Criteria used to assess the financial statements were generally accepted accounting principles. A high level of assurance was obtained. The type of engagement conducted was: 3) _____
- A) audit
 - B) management consulting
 - C) review
 - D) compilation

Answer: A

- 4) George had a conversation with the accounting personnel and documented information about how the accounting systems function. He has also placed copies of accounting forms in his files. George is performing which task? 4) _____
- A) evidence gathering
 - B) audit report preparation
 - C) tax audit
 - D) accounting procedures

Answer: A

- 5) The auditor and the entities should agree on the criteria to be used in the audit 5) _____
- A) as they progress with the audit as they can determine which criteria is more suitable.
 - B) at the end of the audit.
 - C) before the audit starts.
 - D) after the audit planning has been done.

Answer: C

- 6) Because an external auditor is paid a fee by a client company, he or she 6) _____
- A) may be sufficiently independent to conduct an audit.
 - B) is absolutely independent and may conduct an audit.
 - C) must receive approval of the relevant provincial securities commission before conducting an audit.
 - D) is never considered to be independent.

Answer: A

- 7) It is important for the auditor to be independent because 7) _____
- A) the auditor might not be as knowledgeable of the subject matter and the criteria.
 - B) the auditor would not charge a fair rate to the client.
 - C) the audit conclusions cannot be relied upon if the auditor was biased in accumulating and evaluating evidence.
 - D) the Canadian Tax Authorities require that the auditor be independent.

Answer: C

- 8) The auditor's report is 8) _____
- A) the report presented to management about the possible improvements.
 - B) the communication of audit findings to users.
 - C) the invoice of the auditor detailing the work they have performed.
 - D) the set of audited financial statements.

Answer: B

- 9) In the audit of an individual's tax return, the criteria used would be 9) _____
- A) the client's policies for taxable income.
 - B) the Income Tax Act.
 - C) the auditor's judgement.
 - D) GAAP.

Answer: B

- 10) Joe is recording sales transactions in the accounting system so that they can be summarized in a logical manner for the purpose of providing financial information for decision-making. Joe is doing 10) _____
- A) review.
 - B) management consulting.
 - C) auditing.
 - D) accounting.

Answer: D

- 11) In "auditing" accounting data, the concern is with 11) _____
- A) determining if taxable income has been calculated correctly.
 - B) analyzing the financial information to be sure that it complies with government requirements.
 - C) determining whether recorded information properly reflects the economic events that occurred during the accounting period.
 - D) determining if fraud has occurred.

Answer: C

- 12) What type of organizations use auditing services? 12) _____
- A) Non-for-profit organizations
 - B) Businesses
 - C) Governments
 - D) All of the above

Answer: D

- 13) An accountant records information. When conducting an audit, the distinguishing abilities are the 13) _____
- A) ability to interpret generally accepted accounting principles.
 - B) accumulation and interpretation of evidence.
 - C) requirement to possess education beyond the bachelor's degree.
 - D) organize and summarize economic events.

Answer: B

- 14) In Canada, publicly traded company 14) _____
- A) are not required to have an audit.
 - B) are required to have audits.
 - C) are not required to have an audit if they have a review.
 - D) are strongly encouraged to have audits.

Answer: B

- 15) A shareholder of a public Canadian firm can have access to the audited financial statements 15) _____
- A) requesting a copy from the auditors.
 - B) on the internet.
 - C) if he holds more than 1% of the shares of the company.
 - D) by calling the accounting department of the company.

Answer: B

- 16) A reason for private companies to be audited is 16) _____
- A) facilitating access to capital.
 - B) ensuring that their financial statement do not contain errors.
 - C) having a professional accountant perform their bookkeeping.
 - D) complying with the laws requiring them to be audited.

Answer: A

- 17) The Sarbanes-Oxley Act requires the auditor to attest to 17) _____
- A) the accuracy of the financial statements.
 - B) the efficiency of the internal controls in financial reporting.
 - C) the compliance of the company with the generally accepted accounting principles.
 - D) the effectiveness of internal controls.

Answer: D

- 18) There is an increasing demand for assurance about computer controls surrounding financial information transacted electronically and the security of the information related to the transaction. This is in large part due to 18) _____
- A) the use of computer assisted auditing tools.
 - B) client's uncertainty about the proper functioning of their computer system.
 - C) the increasing presence of internet sales in many businesses.
 - D) the many transactions and information shared online and in real time by companies.

Answer: D

- 19) The WebTrust principle of processing integrity refers to 19) _____
- A) providing assurance that access to the system and data is restricted to authorized individuals.
 - B) providing assurance that the transactions are processed completely and accurately.
 - C) providing assurance that the information designated as confidential is protected.
 - D) providing assurance that the systems and data will be available to the users when they need it.

Answer: B

- 20) The WebTrust principle of security refers to 20) _____
- A) providing assurance that access to the system and data is restricted to authorized individuals.
 - B) provides assurance that the information designated as confidential is protected.
 - C) providing assurance that the systems and data will be available to the users when they need it.
 - D) providing assurance that the transactions are processed are completely and accurately.

Answer: A

21) The auditor must have a thorough understanding of the entity and its environment. The auditor must also consider the client's business strategies, processes, and measurement indicators for critical success factors related to those strategies. This analysis helps the auditor 21) _____

- A) identify the potential for fraud in the financial reporting process.
- B) assess the level of materiality that is appropriate for the audit.
- C) decide if they want to accept the engagement.
- D) identify risks associated with the client's strategy that could affect the financial statements.

Answer: D

22) Blader Ng. Inc. has recently placed into production new air-cleaning systems in their smoke-stacks to meet clean-air quality regulations. PA has been engaged to assess air quality and compare results to legislated requirements. What type of audit or engagement is PA conducting? 22) _____

- A) compliance
- B) financial statement
- C) operational
- D) review

Answer: A

23) A review of any part of an organization's procedures and methods for the purpose of evaluating efficiency and effectiveness is classified as a(n) 23) _____

- A) operational audit.
- B) compliance audit.
- C) production audit.
- D) audit of financial statements.

Answer: A

24) Which one of the following is more difficult to evaluate objectively? 24) _____

- A) presentation of financial statements in accordance with Canadian generally accepted accounting principles
- B) compliance with government regulations
- C) efficiency and effectiveness of operations
- D) All three of the above are equally difficult.

Answer: C

25) A typical objective of an operational audit is for the auditor to 25) _____

- A) make recommendations for improving performance.
- B) evaluate the feasibility of attaining the entity's operational objectives.
- C) report on the entity's relative success in attaining profit maximization.
- D) determine whether the financial statements fairly present the entity's operations.

Answer: A

- 26) Which of the following audits can be regarded as being solely "compliance" audits? 26) _____
- A) an internal auditor's review of his employer's payroll authorization procedures
 - B) Canada Revenue Agency's examinations of the returns of taxpayers
 - C) the Auditor General's evaluation of the computer operations of governmental units
 - D) a public accounting firm's audit of the local school district

Answer: B

- 27) The predominant type of assurance service performed by large public accounting firms is 27) _____
- A) management consulting.
 - B) review.
 - C) compilation.
 - D) audit.

Answer: D

- 28) The No-Name Advertising Rating Agency conducts independent surveys to determine the sources of purchases by consumers (e.g. newspaper ad, magazine ad, television ad). This information is then used by those media (i.e. newspapers, magazines, and television broadcasters) to indicate to purchasers of advertising the breadth of coverage that they have. For example, Small Local Newspaper can say that 10% of the purchasers of soap products made their decisions based upon their ads. This helps in selling advertising. What type of service is No-Name providing? 28) _____
- A) Assurance
 - B) Compilation
 - C) Review
 - D) Attest

Answer: A

- 29) Which of the following services provides a moderate level of assurance about the client's financial statements? 29) _____
- A) Audit
 - B) Review
 - C) Compliance
 - D) Forecasts and projections

Answer: B

- 30) PA is attempting to sell a service to his clients that will provide assurance on information systems reliability. PA is attempting to sell a(n): 30) _____
- A) audit engagement
 - B) WebTrust service
 - C) SysTrust service
 - D) compilation service

Answer: C

- 31) Which of the following services provides no assurance about the client's financial statements? 31) _____
- A) audit
 - B) compilation
 - C) review
 - D) None of the above; they all provide some level of assurance.

Answer: B

32) Herbert Zora is having financial statements prepared by his PA to accompany his tax return. His primary concern is cost. Of the following, the lowest cost engagement that the PA can perform for Zora's financial statements is: 32) _____

- A) WebTrust B) audit C) compilation D) review

Answer: C

33) Auditors General are responsible for auditing which types of organizations? 33) _____

- A) Public companies with shares issued to investors
B) Ministries, departments, agencies, and crown corporations
C) Any organization that submits tax returns to the tax authorities
D) Private companies that have loans outstanding to banks or other creditors

Answer: B

34) In Canada, the two bodies whose members perform most of the attest audits are the 34) _____

- A) CIA and CICA. B) SMAC and CGAAC.
C) SMAC and CICA. D) CICA and CGAAC.

Answer: D

35) External auditors (PAs) can obtain professional experience to satisfy the requirements of their professional designation at which of the following organizations? 35) _____

- A) Any type of business that has accounting personnel
B) Internal audit departments of large organizations
C) Public accounting firms of various sizes only
D) Public accounting firms or auditor general offices

Answer: D

36) To operate effectively, an internal auditor must be independent of 36) _____

- A) the entity.
B) the employer - employee relationship which exists for other employees in the organization.
C) the line functions of the organizations.
D) all of the above.

Answer: C

37) The internal auditor typically reports directly to

37) _____

- A) the board of director and the external auditor
- B) the audit committee and the management of the company.
- C) the audit committee and the board of director.
- D) the management of the company.

Answer: C

ESSAY. Write your answer in the space provided or on a separate sheet of paper.

38) Discuss the differences and similarities between the roles of accountants and auditors. What additional expertise must an auditor possess beyond that of an accountant?

Answer: The role of accountants is to record, classify, and summarize economic events in a logical manner for the purpose of providing financial information for decision making. To do this, accountants must have a sound understanding of the principles and rules that provide the basis for preparing the financial information. In addition, accountants are responsible for developing systems to ensure that the entity's economic events are properly recorded on a timely basis and at a reasonable cost.

The role of auditors is to determine whether the financial information prepared by accountants properly reflects the economic events that occurred. To do this, the auditor must not only understand the principles and rules that provide the basis for preparing financial information, but must also possess expertise in the accumulation and evaluation of audit evidence. It is this latter expertise that distinguishes auditors from accountants.

39) Frederic is an account manager at a large Canadian bank. Frederic has to decide if the bank will make a loan to Frost Corp, a snow removal company. Further, Frederic has to decide how much they will lend to Frost and at what rate.

Assuming that Frederic makes the loan, what factors will he use to decide the rate of interest? What factors are impacted by auditing and how?

Answer: 1 - Risk free interest rate: Rate bank could earn in a risk free investment such as government bonds.
2 - Business risk for the customer: Possibility that the customer will not be able to repay their loan because of economic or business conditions.
3 - Information risk - Possibility that the information upon which the business decision was made was inaccurate.

The audit impacts the 3rd factor. The importance of an audit is reflected as there is less risk of the financial misstatement containing material errors if they have been audited. Having a set of audited financial statement can reduce the information risk and increase the likelihood that the bank will make the loan.

40) To do an audit, it is necessary to have information in a verifiable form and some criteria by which the auditor can evaluate the information. (A) What information and criteria would a public accounting firm use when auditing a company's financial statements? (B) What information and criteria would a Canada Revenue Agency auditor use when auditing that same company's tax return? (C) What information and criteria would an internal auditor use when performing an operational audit to evaluate whether the company's computerized payroll processing system is operating efficiently and effectively?

Answer: (A) The information used by a public accounting firm in a financial statement audit is the financial information in the company's financial statements. The criteria used are Canadian generally accepted accounting principles.

(B) The information used by a Canada Revenue Agency auditor is the financial information in the auditee's federal tax return. The criterion is the Income Tax Act and interpretations.

(C) The information used by an internal auditor when performing an operational audit of the payroll system could include various items such as the number of errors made, costs incurred by the payroll department, and number of payroll records processed each month. The criteria would consist of company standards for departmental efficiency and effectiveness.

41) Two types of services provided by public accounting firms are audits and reviews. Discuss the similarities and differences between these two types of services. Which type provides the most assurance?

Answer: Two primary types of services are: audits of historical financial statements and reviews of historical financial statements. While both services involve the accumulation and evaluation of evidence regarding assertions made by management in the company's financial statements, an audit involves a more extensive examination and provides a higher level of assurance about the client's financial statements than a review.

42) Mega Manufacturing Company is thinking about acquiring Localized Small Producer Inc., a small manufacturing company that produces related products. Mega has examined the financial statements of the company, which show only a small profit in the last five years. Management has taken reasonable salaries, and cost of goods sold is higher than the industry average for Localized. Mega believes that they will be able to introduce operational efficiencies, improving the profitability of the small company, if acquired.

Required:

A) What type of engagement should be conducted to assess the operational efficiencies of Localized? Justify your response.

B) Who should be engaged to conduct the engagement?

C) What major problems might the auditors encounter when conducting the audit and writing the report?

Answer: A) Mega should have an operational audit conducted. An operational audit is a review of any part of an organization's operating procedures and methods for the purpose of evaluating economy, efficiency, and effectiveness.

B) The operational audit could be conducted by Mega's internal auditors, assuming that they have internal auditors. It could also be conducted by a public accounting firm. For reasons of independence, if Mega is a listed company (see Chapter 2 of the textbook), then Mega should engage a different public accounting firm than its present auditors.

C) Operational audits are not easily defined. First, the auditors would need to prepare criteria with the assistance of management to define efficiency. Then, the auditors would need to consider the type of evidence that might be available. For example, if Localized has older manufacturing equipment than Mega, Localized might be operating at peak efficiency — evidence will need to be geared to the criteria. Then, the report will need to be prepared in the context of the criteria and the evidence that will be collected. As there are no standard reports in operational auditing, the auditors will need to customize the report based upon the criteria and evidence collected.

43) Jordan set up a nonprofit corporation several years ago to provide scholarships to poor youth in his community. From a small start, Scholarships Get up and Go Foundation now has assets of over \$5 million, and provides about ten university scholarships every year. Jordan is proud of the new doctors, dentists and other health care practitioners that his Foundation has funded.

Jordan is thinking of starting another foundation in an old building that he has purchased. It would be a youth drop in centre, with music lessons, art facilities, basketball facilities in a gym, with linkages to local high schools so that there could be a homework club to encourage good grades.

Required:

A) Why should Jordan have the financial statements of both of these foundations audited?

B) Who would be the users of the financial statements of the foundations?

C) What other types of services could PAs provide to Jordan and the foundations?

Answer: A) Auditing provides added assurance with respect to the information provided in the financial statements: perhaps he could get a better interest rate on invested funds at a financial institution. It might also give added credibility to potential donors of funds. If the Foundations are registered Canadian Charities, they are required to have an audit to keep their registration status.

B) Users could be financial institutions that are holding the Foundations' money, Jordan, his employees, donors and potential donors, tax authorities, and organizations that regulate charitable organizations, such as provincial and federal regulatory agencies. If the Foundations receive government funding, then the organizations providing funding would also be users of the financial statements.

C) PAs could provide advice on how to invest the capital funding that is used for the scholarships.

They could help design the accounting procedures in place at both foundations.

They could provide bookkeeping and compilation assistance, as well as preparing tax returns and any regulatory filings.

They could assist the foundation in obtaining working capital funding for the new drop in centre, if needed.

- 44) You, PA, have been asked to prepare the year-end financial statements of your sister. Betty is a photographer, and is the sole shareholder of a small company called Best Weddings Ltd. She photographs weddings, graduations and schools, earning about \$75,000 per year. Betty has said that she only needs the financial statements for her tax returns, and would like you to prepare the tax returns too.

Required:

- A) Would you be able to prepare the financial statements for your sister? Why or why not?
- B) If yes, what type of report would you prepare to accompany the financial statements?
- C) Would you be able to prepare the tax returns for your sister? Why or why not?

Answer: A) Yes, I would be able to prepare the financial statements as a bookkeeping (or compilation) assignment. No assurance is provided for a compilation, so independence is not required.

An audit or review could not be prepared, because for those engagements, assurance is provided, which means that I would need to be independent.

B) A compilation report would be prepared to accompany the financial statements. The report would need to disclose the relationship and that independence was absent.

C) Yes, I would be able to prepare the tax returns, as assurance is not required for tax returns. Identification of the preparer is required on tax returns. It would be important to discuss with my sister why she wants me to prepare the tax returns (does she just want to save some money?) or is she trying to prepare tax returns that are fraudulent (to save taxes). Even for a sister, it would be inappropriate (and professionally dangerous) to be associated with false and misleading information, with the potential to be sued by the tax department and expelled from the profession.

- 45) There are four types of auditors: public accountants, government auditors, Canada Revenue Agency auditors and internal auditors. Briefly describe the work and responsibilities of each type.

Answer: Public Accountants: Primary function is the audit of financial statements of publicly traded companies. The type of audit normally performed is known as an attestation engagement because they attest to the fair presentation of the financial statements. To conduct audit of financial statements of large public companies, the auditor must be a CA or a CGA meeting the licensing requirements.

Government Auditors: Primary function is the audit of ministries, departments and agencies which report to the government. A government auditor performs the audit function for the government.

Canada Revenue Agency Auditors: Primary responsibility is the enforcement of federal tax laws. The Canada Revenue Agency auditors audit the returns of taxpayers to determine whether they have complied with the tax laws. They only perform compliance audit.

Internal Auditors: Internal auditors are normally members of the IIA and work for individual companies to audit for management. The internal auditor's responsibilities can vary considerably but often include operations auditing and report their findings directly to the board of director and audit committee. The internal auditor must be independent from the line function in the organization he is auditing.