

Chapter 1

The Demand for Audit and Other Assurance Services

Concept Checks

C1-1 *What is meant by determining the degree of correspondence between information and established criteria? What is the criteria for the audit of a company's financial statements?*

To do an audit, there must be information in a *verifiable form* and some standards (*criteria*) by which the auditor can evaluate the information. Determining the degree of correspondence between information and established criteria is determining whether a given set of information is in accordance with the established criteria. For an audit of a company's financial statements the criteria are International Financial Reporting Standards, Accounting Standards for Private Enterprises, Accounting Standards for Not-for-Profits.

C1-2 *What are the major causes of information risk. How can information risk be reduced?*

Information risk reflects the possibility that the information upon which the business risk decision was made was inaccurate. The major causes of information risk are: remoteness of information, biases and motives of the provider, voluminous data, and complex exchange transactions. Users can reduce information risk by examining the information directly, sharing the risk with the information preparer, or requesting some assurance over the information (either an audit or a review engagement).

C1-3 *Explain how and why the auditor makes information trustworthy and credible.*

External users value the auditor's assurance because of the auditor's integrity, independence, expertise, and knowledge of the subject matter. This makes the information credible and trustworthy.

C1-4 *Describe and explain the differences and similarities between financial statement, compliance, and operational audits.*

Differences—are based upon the information and criteria being audited: a financial statement audit (e.g., historical financial statements) assesses evidence with respect to potential material misstatements; a compliance audit (e.g., compliance with environmental legislation) assesses the organization's ability to comply with legislation; and an operational audit (e.g., effective factory production) helps to provide good quality control and manage costs.

Similarities—The auditor is acting with due care, meaning that he/she is following some type of systematic process governed by auditing standards (financial statements: *CPA Canada Handbook* (GAAS); compliance: *CPA Canada Handbook* or IIA standards, depending upon whether a public accountant is conducting the audit; and operational: most likely IIA standards). The auditor is also independent and competent (although the degree of independence will vary according to who is conducting the audit).

C1-5 Describe and explain the difference and similarities among the various types of auditors.

| Auditor | Types of Engagements and Employers | Type of Training |
|-----------------------------|--|---|
| Internal Auditor | Tend to perform compliance, financial, and operational audits (although can include fraud audits). Work for large for-profit and not-for-profit organizations (e.g., hospitals, universities). | Although there is no requirement for a designation, internal auditors often have a CPA or a CIA designation. Internal auditors receive extensive training on how to conduct operational audits. |
| Government Auditor | Performs value-for-money audits, financial statement audits, and operational audits. Increasing opportunity for experience in operational auditing. Employed by provincial or federal government. | Government auditors generally have a CPA designation (if employed by the auditor general), although some have a CIA designation. |
| CRA Auditor | Performs compliance audits related to personal, corporate, and value-added taxes (GST/HST). Works for the Canada Revenue Agency. | Many CRA auditors have a CPA designation (although not required). |
| Fraud and forensic auditors | Performs forensic and fraud audits. Many forensic accountants and fraud auditors work for public accounting firms (or firms that specialize in forensic accounting services). Some also work in industry, government, and large not-for-profits (as part of internal audit). | Many forensic accountants and fraud auditors have a CPA designation (although not required). Some have a CIA designation or one of the fraud specialist designations. |
| Public Accountant | The main engagements are related to assurance of financial information for a wide range of enterprises and industries – particularly financial statement audits. However, can also perform compliance and operational audits. Opportunity for experience in auditing, tax consulting, and management consulting practices. | Public accountants have a CPA designation as well as a public accountant's license. |

Review Questions

1-1 You will be looking at his accounting records (evidence) and evaluating and collecting information about those records. Your evaluation process will be done using relatively standard audit procedures (part of GAAS – generally accepted auditing standards). Your objective is to compare the evidence (his accounting records) to the financial statements that he has prepared (which will become information available to others, such as the Canada Revenue Agency). To help you evaluate his records (the evidence) you will use criteria (likely ASPE – Accounting Standards for Private Enterprises). You are able to add value to the financial statements because you are an independent professional qualified accountant.

1-2 This apparent paradox arises from the distinction between the function of auditing and the function of accounting. The accounting function is the recording, classifying, and summarizing of economic events to provide relevant information to decision makers. The rules of accounting are the criteria used by the auditor for evaluating the presentation of economic events for financial statements and he or she must therefore have an understanding of accounting standards, as well as auditing standards. The accountant need not, and frequently does not, understand what auditors do, unless he or she is involved in doing audits, or has been trained as an auditor.

1-3 Auditor independence is fundamental to the conduct of the audit and the auditor's role in protecting the public interest. In the case of the financial statement audit, when independence is impaired, the credibility of the financial statements, the auditor, and the auditor's report becomes questionable.

This famous quote from Chief Justice Warren Burger, of the US Supreme Court, highlights the auditors' responsibility:

The independent auditor assumes a public responsibility transcending any employment relationship with the client. The independent public accountant performing this special function owes ultimate allegiance to the company's creditors and stockholders, as well as to [the] investing public. This 'public watchdog' function demands that the accountant maintain total independence from the client at all times and requires complete fidelity to the public trust.

1-4 Auditors' lack independence can negatively influence professional skepticism in many ways. If auditors are not independent, then they may not critically examine the evidence or question management's explanations when following up on unusual findings. For instance, if the auditor has audited the company for several years and find management to be honest and forthcoming, that past experience (which is referred to as a familiarity threat to independence) may lead the auditors to readily accept answers without attempting to corroborate the explanations (in other words not perform a critical examination).

1-5 To do an audit, there must be information in a verifiable form and some standards (criteria) by which the auditor can evaluate the information. Examples of established criteria include International Financial Reporting Standards (IFRS) or Accounting Standards for Private Enterprises (ASPE), and the *Income Tax Act*. Determining the degree of correspondence between information and established criteria is determining whether a given set of information is in accordance with the established criteria using audit procedures that conform with GAAS – generally accepted auditing standards. The information for Glickle Ltd.'s tax return is the corporate tax returns filed by the company. The criteria are the *Income Tax Act* and all interpretations. For the audit of Glickle Ltd.'s financial statements, the information is the financial statements being audited and the established criteria are ASPE or IFRS and generally accepted auditing standards.

1-6 The auditor will use risk assessment skills for several purposes:

- To assess the quality and effectiveness of the client's risk assessment processes
- To assess the likelihood of fraud, error, or other misstatements in the client's financial statements
- To select the type of audit evidence that will need to be accumulated to mitigate the risks of fraud, error or misstatement in the client's financial statements
- For other assurance engagements (i.e. non-financial statements), the auditor will similarly need to assess potential risks of error or fraud and design or select audit procedures in response to those risks

1-7 The auditor must assess risks to select the appropriate evidence to be collected. If the auditor does not know the risks, then the wrong evidence might be collected, or the wrong quality or amount of evidence might be collected.

1-8 Assuming a bank is deciding to make a loan to a business, the bank will charge a rate of interest determined primarily by the following three factors:

- *Risk-free interest rate.* This is approximately the rate the bank could earn by investing in Canadian treasury bills for the same length of time as the business loan.
- *Business risk.* This risk reflects the possibility that the business will not be able to repay its loan because of economic or business conditions such as a recession, poor management decisions, or unexpected competition in the industry.
- *Information risk.* This risk reflects the possibility that the information upon which the business risk decision was made was inaccurate. A likely cause of the information risk is the possibility of inaccurate financial statements.

Auditing has no effect on either the risk-free interest rate or business risk. However, auditing can significantly reduce information risk.

1-9 Information risk is the risk that information upon which a business decision is made is inaccurate. Fair value accounting is often based on estimates and requires judgment. Fair value can be estimated using multiple methods with some estimates being more subjective than others. Fair value estimates are made at a point in time, but can also change rapidly, depending on market conditions. All of these factors increase information risk.

1-10 The major differences in the scope of audit responsibilities are:

- Public accountants perform audits in accordance with generally accepted auditing standards of published financial statements prepared in accordance with an acceptable financial reporting framework
- Government auditors from the auditors general (federal or provincial) perform compliance or operational (value-for-money) audits in order to assure the Parliament that the expenditure of public funds is in accordance with its directives and the law and is done with efficiency, economy and effectiveness. They also do financial statement audits of Crown Corporations, or sub-contract this work to external public accountants.
- Canada Revenue Agency auditors perform compliance audits to enforce the federal tax laws as defined by Parliament, interpreted by the courts, and regulated by the *Income Tax Act*.

- Internal auditors perform compliance or operational audits in order to assure management or the board of directors that controls and policies are properly and consistently developed, applied and evaluated.

1-11 Some Potential Engagements Include:

| | Financial Information | Non Financial Information |
|--------------------|--|---|
| Internal Auditor | Audit of credit card expenditures and accounts payable expenses to determine if well-supported and for legitimate business purpose | Business Continuity Audit to test if systems can continue in the event of unforeseen incidences |
| Government Auditor | Costs associated with a capital project funded by government. | A variety of value for money audits – such as a direct report on management and use of surgical facilities |
| Forensic Auditor | Fraud investigation into misappropriation of funds at community clinics | Attestation report on internal controls over payroll |
| Public Accountant | Financial statements and other financial information | Attestation Report on Internal Control over Financial Reporting WebTrust or SysTrust report could be prepared for transactions made via the hospital’s secure web site or with respect to the quality of information systems used to process prescription medication Compliance with Agreements |

Note: These are examples, and the list can be endless, depending upon the Hospital’s needs.

| 1-12 | | | |
|------------------------------|--|--|--|
| | Audits of Financial Statements | Compliance Audits | Operational Audits |
| Objective | To determine whether the financial statements are presented in accordance with an acceptable financial reporting framework | To determine whether the client is following specific procedures set by higher authority | To evaluate whether operating procedures are efficient and effective |
| Users of Audit Report | Different groups for different purposes—mainly outside entities | Authority setting down procedures, internal or external | Management of organization |

| | | | |
|---------------------------------------|---|---|-------------------------|
| Nature | Highly standardized | Not standardized, very specific, often very subjective, but usually objective | Highly non-standardized |
| Performed By: | | | |
| Public Accountant | Almost universally | Occasionally | Frequently |
| Government Auditors | Occasionally | Frequently | Frequently |
| Canada Revenue Agency Auditors | Never | Universally | Never |
| Internal Auditors | Never, although they might review them for management | Frequently | Frequently |

1-13 Five specific examples of operational audits that could be conducted by an internal auditor in a manufacturing company are:

- Examination of employee time cards and personnel records to determine if sufficient information is available to maximize the effective use of personnel.
- Review the processing of sales invoices to determine if it could be done more efficiently.
- Review the acquisitions of goods, including costs to determine if they are being purchased at the lowest possible cost considering the quality needed.
- Review and evaluate the efficiency of the manufacturing process.
- Review the processing of cash receipts to determine if they are deposited as quickly as possible.

Other examples are possible.

1-14 The higher the level of assurance provided, the greater the confidence the individual can place in the matter being assured. Reasonable assurance means a high but not absolute level of assurance. In order to provide reasonable assurance, the auditor must conduct an in-depth and rigorous assessment of the matter being audited.

A limited assurance engagement provides a moderate level of assurance; therefore, the level of testing is lower and consequently it implies a lower level of confidence.

1-15 When auditing historical financial statements, an auditor must have a thorough understanding of the client and its environment. This knowledge should include the client's regulatory and operating environment, business strategies and processes, and measurement indicators. This strategic understanding is also useful in other assurance or consulting engagements. For example, an auditor who is performing an assurance service on information technology would need to understand the client's business strategies and processes related to information technology, including such things as purchases and sales via the Internet. Similarly, a practitioner performing a consulting engagement to evaluate the efficiency and effectiveness of a client's manufacturing process would likely start with an analysis of various measurement indicators, including ratio analysis and benchmarking against key competitors.

1-16 The type of auditor would vary according to the subject matter and the company's assurance needs. A public accountant, internal auditor, or a forensic auditor could all potentially provide assurance and nonassurance services. For example, a public accountant would audit the company's financial statements and could provide a variety of other assurance services, such as attesting the internal controls over financial reporting or providing assurance over the manufacturing process, its sustainability practices, or compliance with certain human rights legislation. It could also provide nonassurance services such as preparation of tax returns. With the exception of the audit of the financial statements, an internal auditor could provide similar assurance services. It could also provide operational audits or consulting services. Similarly a forensic or fraud auditor could perform a fraud audit or could provide a consulting engagement to help develop fraud prevention controls, etc.

Multiple Choice Questions

1-17 a. (3) b. (2) c. (2) d. (1)

1-18 a. (4) b. (2)

Discussion Problems

1-19

- a. The following parts of the definition of auditing are related to the narrative:
- (1) Virms is being asked to issue a report about qualitative and quantitative information relating to trucks. The trucks are therefore the quantifiable information with which the auditor is concerned.
 - (2) There are three criteria which must be evaluated and reported by Virms: Existence of the trucks on the night of June 30, physical condition of each truck, and fair market value of each truck.
 - (3) Susan Virms will *accumulate* and *evaluate* four basic types of *evidence*:
 - *Count the trucks* to determine their existence.
 - *Use registration documents* held by Charon for comparison to the serial number on each truck to determine ownership.
 - *Examine the trucks* to determine each truck's physical condition.
 - *Examine the current blue book* to determine the fair market value of each truck.
 - (4) Susan Virms, public accountant, appears qualified as a *competent, independent person*. She is a public accountant, and she spends most of her time auditing used automobile and truck dealerships and has extensive specialized knowledge about used trucks that is consistent with the nature of the engagement.
 - (5) The *report results* are to include:
 - which of the 20 trucks are parked in Regional's parking lot the night of June 30
 - the condition of each truck, using established guidelines
 - the fair market value of each truck using the current blue book for trucks
- b. The only parts of the audit which will be difficult for Virms are:

- Evaluating the condition, using the guidelines of poor, good, and excellent. It is highly subjective to do so. If she uses a different criterion than the blue book, the fair market value will not be meaningful. Her experience will be essential in using this guideline.
- Determining the fair market value, unless it is clearly defined in the blue book for each condition.

1-20

- a. The services provided by Consumers Union are very similar to assurance services provided by CPA firms. The services provided by Consumers Union and assurance services provided by CPA firms are designed to improve the quality of information for decision makers. CPAs are valued for their independence, and the reports provided by Consumers Union are valued because Consumers Union is independent of the products tested.
- b. Independent – seen as independent of automotive manufacturers.
Competent – able to perform proper assessments and collect reliable and unbiased data
Trustworthy (competence and character (honesty, self-control, courage, independence, objectivity, sense of public interest))

These characteristics are similar to what is expecting of a reliable auditor.

- c. Incentives and Pressures for Consumers' Union
- Economic – Costs to provide service may be too great, accept advertising from auto manufacturers in its magazine
 - Social – pressure from automotive companies to provide favorable reviews
 - Impact on performance responsibilities - May cause Consumers to “cut corners” or if accede to pressure then reporting quality will decrease (self-interest versus responsibility to the public)
- d. Incentives and pressures for financial statement auditor
- Economic – Client fees, maintain good cost recovery
 - Social – pressure from client or audit partners to adjust the reported opinion
 - Impact on performance responsibilities – Issue incorrect report.
- e. The concepts of information risk for the buyer of an automobile and for the user of financial statements are essentially the same. They are both concerned with the problem of unreliable information being provided. In the case of the auditor, the user is concerned about unreliable information being provided in the financial statements. The buyer of an automobile is likely to be concerned about the manufacturer or dealer providing unreliable information.
- f. The four causes of information risk are essentially the same for a buyer of an automobile and a user of financial statements:
- (1) *Remoteness of information* It is difficult for a user to obtain much information about either an automobile manufacturer or the automobile itself without incurring considerable cost. The automobile buyer does have the advantage of possibly knowing other users who are satisfied or dissatisfied with a similar automobile.

- (2) *Biases and motives of provider* There is a conflict between the automobile buyer and the manufacturer. The buyer wants to buy a high quality product at minimum cost whereas the seller wants to maximize the selling price and quantity sold.
 - (3) *Voluminous data* There is a large amount of available information about automobiles that users might like to have in order to evaluate an automobile. Either that information is not available or too costly to obtain.
 - (4) *Complex exchange transactions* The acquisition of an automobile is expensive and certainly a complex decision because of all the components that go into making a good automobile and choosing between a large number of alternatives.
- g. The three ways users of financial statements and buyers of automobiles reduce information risk are also similar:
- i. *User verifies information himself or herself* That can be obtained by driving different automobiles, examining the specifications of the automobiles, talking to other users and doing research in various magazines.
 - ii. *User shares information risk with management* The manufacturer of a product has a responsibility to meet its warranties and to provide a reasonable product. The buyer of an automobile can return the automobile for correction of defects. In some cases a refund may be obtained.
 - iii. *Examine the information prepared by Consumer Reports* This is similar to an audit in the sense that independent information is provided by an independent party. The information provided by *Consumer Reports* is comparable to that provided by a CPA firm that audited financial statements.

1-21

- a. The interest rate for the loan that requires a review report is lower than the loan that did not require a review because of lower information risk. A review report provides moderate assurance to financial statement users, which lowers information risk. An audit report provides further assurance and lower information risk. As a result of reduced information risk, the interest rate is lowest for the loan with the audit report.
- b. Given these circumstances, Vial-tek should select the loan from Second National Bank that requires an annual audit. In this situation, the additional cost of the audit is less than the reduction in interest due to lower information risk. The following is the calculation of total costs for each loan:

| LENDER | PA SERVICE | COST OF PA SERVICES | ANNUAL INTEREST | ANNUAL LOAN COST |
|----------------------|-------------------|----------------------------|------------------------|-------------------------|
| Existing loan | None | 0 | \$ 142,500 | \$ 142,500 |
| First National Bank | Review | \$ 12,000 | \$ 127,500 | \$ 139,500 |
| Second National Bank | Audit | \$ 20,000 | \$ 112,500 | \$ 132,500 |

- c. Vial-tek should select the loan from First National Bank due to the higher cost of the audit and the reduced interest rate for the loan from First National Bank. The following is the calculation of total costs for each loan:

| LENDER | PA SERVICE | COST OF PA SERVICES | ANNUAL INTEREST | ANNUAL LOAN COST |
|----------------------|-------------------|----------------------------|------------------------|-------------------------|
| Existing loan | None | 0 | \$ 142,500 | \$ 142,500 |
| First National Bank | Review | \$ 12,000 | \$ 120,000 | \$ 132,000 |
| Second National Bank | Audit | \$ 25,000 | \$ 112,500 | \$ 137,500 |

- d. Vial-tek may desire to have an audit because of the many other positive benefits that an audit provides. The audit will provide Vial-tek's management with assurance about annual financial information used for decision-making purposes. The audit may detect errors or fraud, and provide management with information about the effectiveness of controls. In addition, the audit may result in recommendations to management that will improve efficiency or effectiveness.
- e. Since an audit engagement requires persuasive evidence, which requires a greater effort on the part of the auditor in terms of the nature and extent of evidence to be gathered as well as the type of procedures performed, it would be much more costly than a review. An audit also requires that the auditor develop a thorough understanding of controls, which is not required for a review engagement.
- f. The auditor must have a thorough understanding of the client and its environment, including the client's e-commerce technologies, industry, regulatory and operating environment, suppliers, customers, creditors, and business strategies and processes. This thorough analysis helps the auditor identify risks associated with the client's strategies that may affect whether the financial statements are fairly stated. This strategic knowledge of the client's business often helps the auditor identify ways to help the client improve business operations, thereby providing added value to the audit function.

1-22

- a. Financial statement audits reduce information risk, which lowers borrowing costs. An audit also provides assurances to management about information used for decision-making purposes, and may also provide recommendations to improve efficiency or effectiveness of operations.
- b. Hogan and Czarnecki likely provide tax services, accounting services, and management advisory services. They may also provide additional assurance services other than audits of financial statements.
- c. Student answers will vary. They may identify new types of information that require assurance, such as environmental or corporate responsibility reporting. Students may also identify opportunities for consulting or management advisory services, such as assistance with the adoption of International Financial Reporting Standards.

1-23 The major advantages and disadvantages of a career as an CRA auditor, public accountant, internal auditor, or provincial auditor are:

| EMPLOYMENT | ADVANTAGES | DISADVANTAGES |
|--------------------|---|---|
| CRA Auditor | <ol style="list-style-type: none"> 1. Extensive training in individual, corporate, gift, trust, and other taxes is available with concentration in area chosen. 2. Hands-on experience with sophisticated selection techniques. | <ol style="list-style-type: none"> 1. Experience limited to taxes. 2. No experience with operational or financial statement auditing. 3. Training is not extensive with any business enterprise. |
| Public Accountant | <ol style="list-style-type: none"> 1. Extensive training in audit of financial statements, compliance auditing and operational auditing. 2. Opportunity for experience in auditing, tax consulting, and management consulting practices. 3. Experience in a diversity of enterprises and industries with the opportunity to specialize in a specific industry. | <ol style="list-style-type: none"> 1. Exposure to taxes and to the business enterprise may not be as in-depth as the internal revenue agent or the internal auditor. 2. Likely to be less exposed to operational auditing than is likely for internal auditors. |
| Internal Auditor | <ol style="list-style-type: none"> 1. Extensive exposure to all segments of the enterprise with which employed. 2. Constant exposure to one industry presenting opportunity for expertise in that industry. 3. Likely to have exposure to compliance, financial, and operational auditing. | <ol style="list-style-type: none"> 1. Little exposure to taxation and the audit of taxes. 2. Experience is limited to one enterprise, usually within one or a limited number of industries. |
| Provincial Auditor | <ol style="list-style-type: none"> 1. Increasing opportunity for experience in operational auditing. 2. Exposure to value-for-money auditing 2. Exposure to highly sophisticated statistical sampling and computer auditing techniques. | <ol style="list-style-type: none"> 1. Limited to government entities (although can be wide variety of entities). 2. Bureaucracy of provincial government. |

b. The two best choices for the senior interested in becoming a certified fraud examiner would be starting out as either a CPA or an internal auditor. A CPA gains experience with internal controls and has an understanding of incentives and opportunities to commit fraud. An internal auditor gains experience with internal controls and has an in-depth understanding of operations and the many facets of a business. CRA auditors and provincial auditors would be in demand for fraud examinations relating specifically to tax fraud or fraud at governmental entities (as was highlighted in the opening vignette).

c. Other auditing careers that are available are:

- Auditors within many of the branches of the federal government and the Auditor General of Canada.
- Auditors for municipal governments (as highlighted in the chapter).
- Internal auditors with large non-profit organizations, including hospitals and universities.
- Fraud auditors and forensic accountants (these could be with large organizations, specialized practices, or public accounting firms).

1-24

a. The vision of the Global Reporting Initiative (GRI) is a sustainable global economy where organizations manage their economic, environmental, social and governance performance and impacts responsibly, and report transparently. Its mission is to make sustainability reporting standard practice by providing guidance and support to organizations.

b. According to the GRI “A sustainability report is a report published by a company or organization about the economic, environmental, and social impacts caused by its everyday activities. A sustainability report also presents the organization's values and governance model, and demonstrates the link between its strategy and its commitment to a sustainable global economy.”

In an integrated report, sustainability information is included along with financial information. These reports emphasize the links between financial and non-financial performance. An integrated report also presents the risks and opportunities the company faces, integrated with disclosure of environmental, social, and governance issues.

c. GRI offers two “in accordance” reporting options, Core and Comprehensive. The Core report provides the essential elements of a sustainability report. The Comprehensive report includes additional disclosures of the organization’s strategy and analysis, governance, and ethics and integrity. The GRI recommends external assurance, but it is not required for either type of “in accordance” report.

1-25 Instructors should direct students to their provincial CPA association to refer to the educational requirements for the CPA Certification. The CPA education program is a national program which is administered by each provincial body. Educational requirements are consistent from province to province and students.

a. The educational requirements for the CPA certification program are:

- Post-secondary degree (120 credit hours or 90 credit hours) with appropriate subject coverage. If the student’s degree is less than 120 hours or does not have the appropriate subject coverage, students may get that coverage through the CPA preparatory courses (formerly CPA PREP).
- Completion of the CPA professional educational program (PEP). Students enrolled accredited university graduate programs may be exempt from some of the CPA PEP modules.
- Common Final Exam (CFE). This is a three-day national exam that all CPA students must pass.

- b. Students may enroll in the CPA certification program without having work experience; however, in order to obtain their designation, they must complete certain work requirements. There are six competencies in which students need to develop proficiency in any three management and/or financial accounting competencies and must have an in-depth proficiency in two competencies (depending upon their career aspirations). Students have two options regarding completion of work experience – employment at pre-approved training office or experience verification (which requires more documentation and certification by supervisor). Both routes require 30 months of progressive experience and students must have a mentor.
- c. Students who wish to obtain a public accountants license, must choose assurance and tax as their electives in the PEP program and must work in an approved training office (which will allow students to develop the required depth for assurance and taxation).
- d. To remain a member in good standing, CPAs must adhere to the CPA Code of Professional Conduct. In addition members must pay their annual membership fees and complete a 120 hours of continuing professional development (CPD) every three years.

NOTE: Each province requires a CPA designation for a public accountant's license and the provincial accounting body is responsible for issuing the license. However, the regulations for each province are slightly different. In Ontario, there is an additional body, the Public Accountants Council of Ontario (PAC), that is responsible for regulating the Public Accountants license. It develops the standards for the PA license and ensures that CPA Ontario meets those standards. The PAC can also fine accountants who practice public accounting without a license.

Professional Judgment Problems and Cases

1-26 The PA firm for the internet company described in this problem could address these customer concerns by performing an assurance service that could attest to the website's site's business practices and controls. This could include:

- Processing integrity for: Accuracy of product descriptions and adherence to stated return policies
- Online privacy and security for: credit card and other personal information
- Online privacy and security for: selling information to other companies
- Availability: The system is available for operation and use as committed or agreed

1-27

- a. The operational efficiency of the sales department could be assessed by a qualified accountant (which could include a PA, internal auditor, or other qualified accountant), while the other departments could be assessed by qualified accountants together with a qualified researcher and manufacturing consultant. Skills present should be familiarity with best business practices in the industry and functional area under audit, as well as skills in information technology, research and development, and production development and management.

- b. The auditors may have difficulty developing criteria to conduct the audit (unless there are standard best practices available for the industry), which will make the engagement more judgmental. They may also have difficulty writing the report, since such audits are unique, and the report will need to be custom-written for the engagement.

1-28

- a. Public accountants can provide assurance services related to the judging process, the voting processes and the information systems used in the pageants. Because they are independent and objective, people will have more confidence in the integrity of the pageant.
- b. This question should prompt consideration of what type of controls could have **prevented** this from happening – perhaps the best way to avoid having errors from occurring would be to automate the process – typos would not occur in those situations. Of course the system would need to be designed so that the scores are accurate and complete (part c would address what type of factors and/or processes would ensure that these type of errors do not occur).

The audit was not performed “real time” or prior to the results being released appears to be how the audit contributed to the breakdown.

- c. Instructors may refer to the article, *How to Make Sure a Typo does not Derail an Award Ceremony* at <http://www.cbc.ca/news/arts/how-to-make-sure-a-typo-doesn-t-derail-a-prize-ceremony-1.1306724>, where Simcoe describes the type of factors (or controls) considered in these type of engagements. The key is to ensure that key processes and controls are in place that ensures secrecy, accuracy, and completeness of the voting.
- d. In the article, Simcoe describes assurance and non-assurance services that PwC provides pageants and awards programs – such as: testing the system and its controls. Simcoe emphasizes the need to be independent and objective because PwC is providing assurance over the integrity of the voting process. However, if PwC was providing consulting services, it could aid in the actual development of the system or provide advice on designing appropriate controls.

1-29

- a.

| <i>Type of work</i> | <i>Stakeholders</i> |
|---|---|
| Financial statement audit | Management, Wu, bank, other users of the financial statements, such as Canada Revenue agency or potential additional lenders or investors |
| Management consulting: set up of accounting systems | Management, users of the systems, such as employees, customers who receive invoices, users of financial reports, as in above |
| Supervision of bookkeeper (management function) | Management, bookkeeper, and users of financial reports |
| Assist with bank negotiations | Management, bank |

- b. An auditor is expected to be independent of management. However, Wu is doing a management function by supervising the bookkeeper, and also advocating on behalf of the client by assisting with bank negotiations. These two actions are Wu representing management, so this would conflict with her ability to do the audit (lack of independence). Also, by setting up the accounting systems, Wu would then be auditing her own work if she is examining the results of the accounting systems during the audit, again causing a problem with independence. It seems that Wu would be unable to do all of this work. She could do the audit OR the other work for the client, but not both, unless some safeguards for her independence are established. This will be discussed further in Chapter 4.

Information from Chapter 3 would indicate that safeguards for independence are:

- the management consulting can be done as long as the work is properly documented and evaluated
- the supervision of bookkeeper can be done as long as management approves all transactions and Wu provides only advice (although this can be a problem if management is not very knowledgeable regarding accounting)
- the assistance with the negotiations can be done as long as Wu advises only, and management makes all of the decisions