

Exam

Name _____

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

- 1) The No-Name Agency conducts an independent service for a company to determine if its suppliers have complied with health and safety regulations, child labour guidelines, and other employee welfare issues. What type of service is No-Name providing? 1) _____
A) compilation B) assurance C) attest D) review

Answer: B

- 2) Blader Ng. Inc. has recently placed new air-cleaning systems in their smokestacks to meet air quality regulations. An auditing firm has been engaged to assess air quality and compare results to legislated requirements. What type of audit or engagement is the auditor conducting? 2) _____
A) review B) financial statement
C) compliance D) operational

Answer: C

- 3) In Canada, publicly traded companies are 3) _____
A) not required to have an audit.
B) required to have audits.
C) not required to have an audit if they have a review.
D) strongly encouraged to have audits.

Answer: B

- 4) A reason for a not-for-profit organization to be audited is to 4) _____
A) have a professional accountant perform their bookkeeping.
B) comply with the laws requiring them to be audited.
C) ensure that their financial statements do not contain errors.
D) meet requirements of lenders or funding sources.

Answer: D

- 5) How does a financial statement auditor help reduce information risk, and make financial statements more trustworthy and reliable? 5) _____
A) By ensuring the business is using its resources efficiently.
B) By confirming that the company is only taking reasonable business risk.
C) By verifying that the company has a credible CSR plan.
D) By bringing integrity, independence, competence, and knowledge of financial statement reporting to the audit of the financial statements.

Answer: D

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

- 6) 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.

Required:

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 a relevant accounting framework such as IFRS or ASPE.

B. The information used by a Canada Revenue Agency auditor is the financial information in the auditee's federal tax return. The criteria are 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.

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

- 7) Which of the following is most difficult to evaluate objectively? 7) _____

A) efficiency and effectiveness of operations

B) compliance with government regulations

C) internal controls in use at a small company

D) presentation of financial statements in accordance with a generally accepted accounting framework

Answer: A

- 8) Auditing should be done by a qualified 8) _____

A) certified management accountant.

B) professional accountant.

C) chartered accountant.

D) competent and independent person.

Answer: D

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

- 9) 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.

- 10) 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: Factors:

1. Risk-free interest rate: The rate the bank could earn in a risk-free investment such as Canada Treasury bills.
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 decisions are made were inaccurate.

Audits impact information risk. Having a set of audited financial statements can reduce the information risk and increase the likelihood that the bank will make the loan and even at a reduced interest rate due to the reliance it can place on the audited financial statements.

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

- 11) As an external auditor is paid a fee by a client company, he or she 11) _____
- A) is absolutely independent and may conduct an audit.
 - B) must receive approval from the relevant provincial securities commission before conducting an audit.
 - C) is never considered to be independent.
 - D) may still be sufficiently independent to conduct an audit.

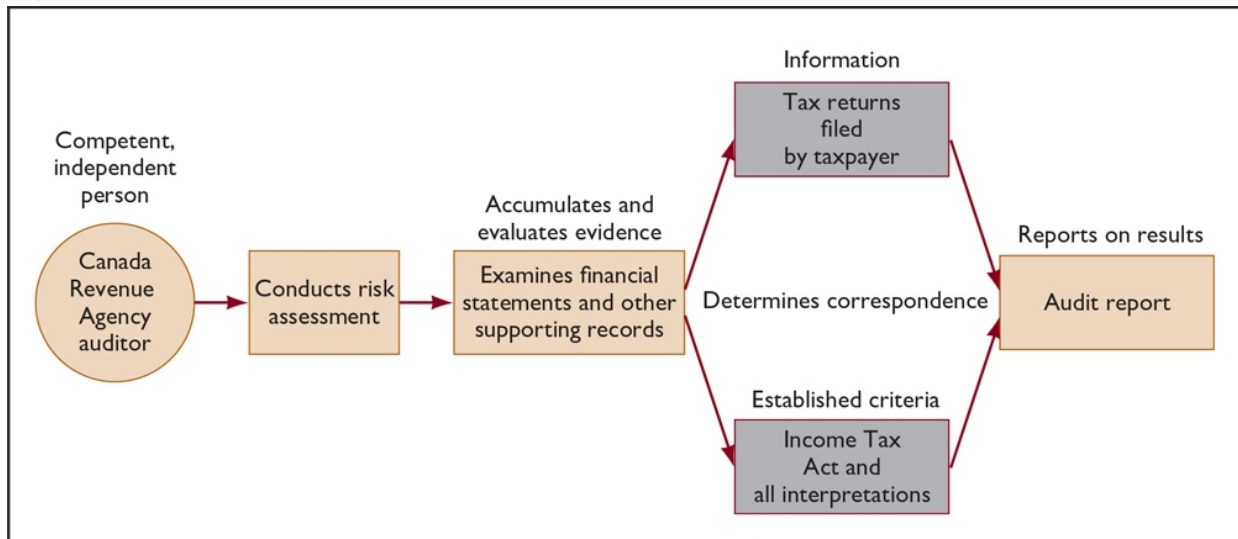
Answer: D

- 12) Annual financial statement audits are required for which of the following situations? 12) _____
- A) Canadian corporations as part of their tax filings with the Canadian Revenue Agency
 - B) Private companies
 - C) Public companies and large not-for-profit organizations
 - D) American corporations as part of filing their tax returns with the IRS

Answer: C

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

13) Figure 1-2



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Use your knowledge of the definition of auditing and Figure 1-2: Audit of a Corporate Tax Return to explain how an auditor would conduct a Corporate Tax Return audit.

Answer: First, the concept of a competent, independent person requires that the practitioner who is conducting an assurance engagement should have "adequate proficiency," which means that the tax auditor should be competent in the fields of taxation and the fields that need to be assessed, such as accounting, information systems, data management and access and internal controls. The auditor should also use due care and have an objective state of mind. This means that the auditor should be independent of the client and do their best using their skills when conducting the audit.

The second part of Figure 1-2 relates to the accumulation and evaluation of evidence using a risk-based approach. This means that the auditor would collect evidence based upon risks of violations in the tax return by the client.

The next three parts are connected. The auditor determines the correspondence of the information provided by the client (which could be the financial statements, tax return and the quality of the calculations within the tax return) to established criteria (the Income Tax Act).

Finally, the auditor issues a report (Notice of Assessment) to summarize the findings.

14) As a PA, you have been asked to prepare your sister Betty's year-end financial statements. Betty is a photographer and is the sole shareholder of a small company called Best Weddings Ltd. She photographs weddings, graduations, and schools, and earns 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, the PA 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 the PA 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, the PA 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 your sister why she wants you to prepare the tax returns (Does she just want to save some money? Or is she trying to prepare tax returns that are fraudulent?). It would be inappropriate (and professionally dangerous) to be associated with false and misleading information, as one could be sued by the tax department and expelled from the profession.

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

15) In the audit of historical financial statements by PA firms, the criteria used are 15) _____
A) regulations of the Canada Revenue Agency.
B) generally accepted auditing standards.
C) relevant accounting frameworks.
D) regulations of the provincial securities commissions.

Answer: C

16) The internal audit group typically reports directly to the 16) _____
A) management of the company. B) board of directors.
C) external auditor. D) audit committee.

Answer: D

17) It is important for the auditor to be independent because 17) _____
A) this will prevent bias in accumulating and evaluating evidence.
B) otherwise, the auditor might not be as knowledgeable of the subject matter and the criteria.
C) the Canadian tax authorities require that the auditor be independent.
D) otherwise, the auditor would not charge a fair rate to the client.

Answer: A

18) Which of the following illustrates the definition of auditing with respect to the reporting process? 18) _____
A) writing an operational audit report that is tailored to the client's situation
B) reporting on the degree of correspondence between financial statements and ASPE/IFRS
C) accumulation and evaluation of evidence about balance sheet accounts
D) making sure that the auditor is competent and understands evidence gathering

Answer: B

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

- 19) We discuss four types of auditors: public accountants, government auditors, Canada Revenue Agency auditors, and internal auditors. Briefly describe the work and responsibilities of each type of auditor.

Answer: Public Accountants: Primary function is the audit of financial statements of publicly traded companies and of other organizations requiring audits. 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 the audit of financial statements, the auditor must be a licensed public accountant.

Government Auditors: Primary function is the audit of ministries, departments, and agencies that 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 audits.

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 reporting their findings directly to the board of directors and audit committee. The internal auditor must be independent from the line function in the organization he/she is auditing.

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

- 20) When do individuals and organizations typically need assurance services? 20) _____
A) only when historical data, such as financial information, need to be audited
B) for five years from the start of an organization until debt is retired
C) whenever assurance is provided by a practitioner who is independent and unbiased
D) usually only when organizations obtain debt or other loans

Answer: C

- 21) 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 21) _____
A) audit. B) compilation. C) review. D) WebTrust.

Answer: B

- 22) 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? 22) _____
A) audit report preparation B) evidence gathering
C) tax audit D) accounting procedures

Answer: B

- 23) What impact is the presence of factors such as real-time information (such as via the Internet) expected to have upon the demand for assurance services? 23) _____
A) Demand is expected to decline due to the lack of adequate resources.
B) Demand is expected to decline as small businesses use the Internet more.
C) Demand is expected to grow due to the need for forward-looking information.
D) Demand is expected to grow due to the increase in large corporations.

Answer: C

- 24) An accountant records information. When conducting an audit, the auditor must possess 24) _____
- A) an ability to organize and summarize economic events.
 - B) an ability to classify transactions by type.
 - C) an education beyond the bachelor's degree.
 - D) an ability to interpret relevant accounting frameworks.

Answer: D

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

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

Required:

- A. What type of engagement should be conducted to assess the operational efficiencies of LSP? 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, 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 LSP has older manufacturing equipment than Mega, LSP 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.

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

- 26) One of the reasons that an auditor must be competent is so that they can 26) _____
- A) capture the information properly in the computer files.
 - B) select the type and amount of evidence to accumulate.
 - C) record the transactions properly for the underlying records.
 - D) explain to staff how the bookkeeping should be done.

Answer: B

- 27) 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 27) _____
- A) the large volume of transactions and information shared online and in real-time by companies.
 - B) the increasing presence of Internet sales in many businesses.
 - C) the use of computer-assisted auditing tools.
 - D) client's uncertainty about the proper functioning of their computer systems.
- Answer: A
- 28) 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 performing 28) _____
- A) review.
 - B) management consulting.
 - C) accounting.
 - D) auditing.
- Answer: C
- 29) As part of its loan agreement, Big Bank requires that only accounts receivable less than 60 days old be used as collateral. An auditor has been engaged to provide assurance that the accounts receivable on the list provided to the bank are indeed less than 60 days old. What type of engagement is the auditor conducting? 29) _____
- A) financial statement
 - B) operational
 - C) review
 - D) compliance
- Answer: D
- 30) The need to implement philosophies and practices commonly referred to as "improved business practices" comes from 30) _____
- A) a need to increase profitability on assurance type mandates.
 - B) an IFRA pronouncement.
 - C) a CAS pronouncement.
 - D) increased competition resulting in public accounting firms being concerned about keeping clients and maintaining a reasonable profit.
- Answer: D
- 31) Which of the following illustrates the definition of auditing with respect to the evidence analysis process? 31) _____
- A) learning about different types of computing technology, such as mainframes
 - B) writing an operational audit report that is tailored to the client's situation
 - C) accumulation and evaluation of evidence regarding assertions
 - D) making sure that the auditor is competent and understands evidence gathering
- Answer: C
- 32) The independent auditor's report is the 32) _____
- A) set of audited financial statements.
 - B) report presented to management about the possible improvements.
 - C) invoice of the auditor detailing the work they have performed.
 - D) communication of the outcome of auditor's evaluation to the users.
- Answer: D

33) Which of the following audits can be regarded as being solely "compliance" audits? 33) _____
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) a public accounting firm's audit of the local school district.
D) the Auditor General's evaluation of the computer operations of governmental units.

Answer: B

34) A shareholder of a public Canadian firm can have access to the audited financial statements 34) _____
A) on the Internet.
B) if he/she holds more than 1% of the shares of the company.
C) by requesting a copy from the auditors.
D) by calling the accounting department of the company.

Answer: A

35) The extent and the scope of the audits conducted by Auditors General are determined by 35) _____
A) the Auditor General and his/her staff.
B) audit partner planning and audit program development.
C) the financial statement auditors of the client.
D) legislation in the Auditor General's jurisdiction.

Answer: D

36) Information risk can be caused through any one of the following *except* 36) _____
A) complex exchange transactions. B) low volume of data.
C) remoteness of information. D) biases and motives of the provider.

Answer: B

37) Which of the following services provides no assurance about the client's financial statements? 37) _____
A) audit B) review C) compilation D) SysTrust

Answer: C

38) An example of a forensic accounting assignment might be 38) _____
A) determining whether overall financial statements are stated in conformity with IFRS.
B) estimating the value of inventory lost in a warehouse theft.
C) ensuring compliance with specific legislation.
D) evaluating the effectiveness of an internal process.

Answer: B

39) When readers are cautioned that the financial statements may not be appropriate for their 39) _____
purposes, the non-assurance service is called a(n)
A) review. B) compilation. C) SysTrust. D) audit.

Answer: B

40) To operate effectively, an internal auditor must be independent of the 40) _____
A) outsourcing organizations used.
B) employer-employee relationship that exists for other employees in the organization.
C) line functions of the organization.
D) entity that is being audited.

Answer: C

- 41) ZK3 Ltd. is a successful 20-year-old private Canadian family-owned business. The company is owned equally by four siblings who are all involved in managing the daily operations of the company. A private equity company is contemplating an investment in ZK3 and insists on audited financial statements. The following are likely explanations for the private equity company's request *except* 41) _____
- A) reducing information risk to the private equity investor.
 - B) remoteness of information related to ZK3's operations.
 - C) Canada Revenue Agency requirements for audited financial statements.
 - D) biases and motives of ZK3 management.

Answer: C

- 42) Which of the following is an example of auditing rather than accounting? 42) _____
- A) recording purchase amounts in the expense accounts
 - B) evaluating whether accounts receivable are collectible
 - C) recording cash received in the customer account files
 - D) posting the daily sales totals to the general ledger

Answer: B

- 43) In the audit of a corporate tax return, the CRA auditor should demonstrate competence in the use of 43) _____
- A) standard personal and corporate tax preparation software.
 - B) external databases that contain economic statistics.
 - C) the *Income Tax Act* and accompanying regulations.
 - D) database management software for the use of client-based research.

Answer: C

- 44) The reasoning behind the requirements of the *Sarbanes-Oxley Act's* section 404 (attestation on internal control over financial reporting) is that 44) _____
- A) better internal controls can be implemented at a lower cost, improving product quality.
 - B) automated controls improve customer service, resulting in higher product sales.
 - C) effective controls reduce the likelihood of future misstatements in the financial statements.
 - D) effective controls result in greater profits to organizations, reducing business failures.

Answer: C

- 45) Information risk can be reduced through any one of the following *except* 45) _____
- A) providing audited financial statements to users.
 - B) having the user verify the information.
 - C) having the user share information risk with management.
 - D) having the chief financial officer certify and sign off on the financial statements.

Answer: D

- 46) Which of the following is an example of a financial statement audit? 46) _____
- A) evaluating the effectiveness and efficiency of internal controls used to record transactions
 - B) determining whether ABC's overall financial statements are stated in conformity with IFRS
 - C) determining whether ABC's financial statements overall do not violate any debt covenants
 - D) evaluating the effectiveness and efficiency of internal controls used to create account balance

Answer: B

- 47) Which of the following is an example of accounting rather than auditing? 47) _____
- A) reviewing sales invoices to see if they have been calculated correctly
 - B) entering sales transactions into the sales order system
 - C) comparing bank deposit documents to the recorded cash received
 - D) gathering evidence about the quality of accounts receivable

Answer: B

- 48) What is the nature of the service provided when an auditor evaluates information using suitable criteria and issues a report that attests to the reliability of the information? 48) _____
- A) internal audit engagement
 - B) attestation engagement
 - C) compilation engagement
 - D) review engagement

Answer: B

- 49) A typical objective of an operational audit is for the auditor to 49) _____
- A) determine whether the financial statements fairly present the entity's operations.
 - B) evaluate the feasibility of attaining the entity's operational objectives.
 - C) report on the entity's relative success in attaining profit maximization.
 - D) evaluate the effectiveness of an internal process.

Answer: D

- 50) In the audit of an individual's tax return, the criteria used would be 50) _____
- A) the auditor's judgment.
 - B) an accounting framework.
 - C) the client's policies for taxable income.
 - D) the *Income Tax Act*.

Answer: D

- 51) In auditing accounting data, the concern is with 51) _____
- A) evaluating whether recorded information reasonably reflects the economic events that occurred during the accounting period within specified dollar ranges.
 - B) determining if fraud has occurred.
 - C) analyzing the financial information to be sure that it complies with government requirements.
 - D) determining if taxable income has been calculated correctly.

Answer: A

- 52) What is the primary difference between internal and external auditors? 52) _____
- A) the parties to whom the auditor is responsible
 - B) the methodology used to conduct financial statement audits
 - C) the level of competence required
 - D) the level of objectivity required

Answer: A

- 53) The *Sarbanes-Oxley Act* requires the auditor to attest to the 53) _____
- A) accuracy of the financial statements.
 - B) effectiveness of internal controls.
 - C) efficiency of the internal controls in financial reporting.
 - D) compliance of the company with the generally accepted accounting framework.

Answer: B

54) What is the most appropriate method for an organization to lower information risk related to its financial statements? 54) _____
A) Have an independent financial statement audit conducted.
B) Hire a good CPA to complete its bookkeeping work.
C) Have an independent operational audit conducted on effectiveness.
D) Use a high-quality software package to keep track of information.

Answer: A

55) Auditors General are responsible for auditing which types of organizations? 55) _____
A) any organization that submits tax returns to the tax authorities
B) ministries, departments, agencies that report to Government
C) public companies with shares issued to investors
D) private companies that have loans outstanding to banks or other creditors

Answer: B

56) A large PA firm has assessed evidence collected during an engagement. Criteria used to assess the financial statements were International Financial Reporting Standards (IFRS). A high level of assurance was obtained. The type of engagement conducted was 56) _____
A) a review. B) a compilation.
C) management consulting. D) an audit.

Answer: D

57) A bank manager is evaluating a loan application for Leonard & Ebelle, the private parent company with three subsidiaries in different sectors, including real estate, retail, and banking. The bank manager has received the unaudited consolidated financial statements for Leonard & Ebelle. The bank manager decides to request audited financial statements from Leonard & Ebelle as a precondition for approving the loan. The following could justify the bank manager's request, *except* 57) _____
A) concerns over complex exchange transactions.
B) concerns over remoteness of information.
C) concerns over voluminous data.
D) audits are mandatory for large private companies.

Answer: D

58) Which of the following services provides a moderate level of assurance about the client's financial statements? 58) _____
A) audit B) forecasts and projections
C) review D) compliance

Answer: C

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

- 59) 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 thorough understanding of the principles and rules that provide the basis for preparing the accounting information. In addition, accountants also help to develop systems to ensure that the entity's economic events are properly recorded in a timely manner and at a reasonable cost.

The role of auditors is to determine whether the recorded financial information prepared by accountants reasonably 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.

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

- 60) A major type of assurance service performed by large public accounting firms is 60) _____
A) auditing. B) reviewing.
C) management consulting. D) compilation.

Answer: A

- 61) The auditor and the entities being audited should agree on the criteria to be used in the audit 61) _____
A) well in advance before the audit starts.
B) at the end of the audit.
C) after the audit planning has been done.
D) as they progress with the audit, as they can determine which criteria are most suitable.

Answer: A

- 62) In the audit of a corporate tax return, the report provided by the Canada Revenue Agency auditor 62) _____
would describe
A) that the corporate income tax return is in compliance with the *Income Tax Act*.
B) the likely accounting errors that could contribute to tax errors.
C) management issues with respect to accurately reporting taxes.
D) an opinion on the likelihood of tax return error.

Answer: A

- 63) What type of information is available from www.sedar.com (System for Electronic Document 63) _____
Analysis and Retrieval)?
A) annual reports and management discussion and analysis
B) listings of all of the shareholders on record
C) minutes of shareholders and directors meetings
D) transaction reports from major credit card companies

Answer: A

64) The underlying conditions that create demand by users for reliable financial information include the fact that 64) _____
A) users are separated from accounting records by distance and time.
B) there is a need for the expression of an opinion as to the fairness of financial statements.
C) governments rely on such information to create tax policies.
D) more reliable information will allow investors to calculate the rate of return on their investment.

Answer: A

65) Which of the following is an example of an attestation engagement? 65) _____
A) completion of provincial and federal tax returns
B) an audit of internal controls over financial reporting
C) preparation of the annual financial statements with notes
D) accounting and bookkeeping services for the accounts

Answer: B

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

Answer: D

67) Michael & Oliver Properties Ltd. is a successful real estate company with headquarters in Oakville, Ontario. Most of its operations occur internationally in Nigeria. Michael & Oliver have a reliable CPA on staff in the Nigerian office who does the bookkeeping and compiles the financial statements. The bookkeeper reports to the CFO in Oakville, who is responsible for filing the taxes in Canada. Lala Inc., a partner on a new development project in Burlington, is insisting on audited financial statements. Which of the following concerns can Lala's financial statement auditors assist in addressing? 67) _____
A) Concerns over client risk B) Concerns over assessment risk.
C) Concerns over business risk D) Concerns over remoteness of information

Answer: D

68) Which of the following is an advantage of a review engagement as compared to an audit engagement? 68) _____
A) For the review engagement, the documentation to be provided by the client is greater.
B) For the review engagement, information risk is reduced more than for an audit.
C) The review engagement requires considerably less work, so is less costly.
D) For the review engagement, the financial statements assessed will have more detail.

Answer: C

69) Auditors are licensed to perform financial statement audits, while accountants are not. Which of the following is a requirement for individuals who perform audits, but not for those performing accounting? 69) _____
A) Independence B) Objectivity
C) Requisite education and training D) Integrity

Answer: A

70) In operational auditing, the auditor studies business operations and makes recommendations about all of the following *except* 70) _____
A) compliance with company policies.
B) economic and efficient use of resources.
C) effective achievement of business objectives.
D) the fairness of the financial statements.

Answer: D

71) A bank manager is evaluating an application for a bank loan from a new corporate client. The bank manager decides to request audited financial statements. Which of the following likely informed this decision? 71) _____
A) The bank manager believes audited financial statements will be necessary for the Canada Revenue Agency.
B) The bank manager believes the opinion of a knowledgeable third party is necessary to reduce the information risk.
C) The bank manager is unsure that the client will be able to continue operating successfully in the future given the economic climate.
D) The bank manager is seeking to lower the risk-free interest rate that applies to the corporation.

Answer: B

72) Which of the following organizations establishes ethical standards and standards for the practice of Internal Auditing? 72) _____
A) Society of Management Accountants of Canada (SMAC).
B) Information Systems Audit and Control Association (ISACA).
C) Institute of Internal Auditors (IIA).
D) Chartered Professional Accountants of Canada (CPA).

Answer: C

73) One of the reasons that an auditor must be competent is so that they can 73) _____
A) understand the engagement risks and the criteria used by the client.
B) capture the information properly in the computer files.
C) explain to staff how the bookkeeping should be done.
D) record the transactions properly for the underlying records.

Answer: A

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

- 74) Jordan set up a not-for-profit corporation several years ago to provide scholarships to disadvantaged youth in his community. 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 healthcare 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 offering music lessons, art facilities, and gym facilities, and would have links to local high schools to offer homework clubs 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, and would also show the assets, liabilities, and any surplus/deficit are reported in the proper entity and have not been reported or used in the wrong entity.

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 prepare tax returns and any regulatory filings. They could assist the foundation in obtaining working capital funding for the new drop-in centre, if needed.

Answer Key

Testname: CH01

- 1) B
- 2) C
- 3) B
- 4) D
- 5) D
- 6) 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 a relevant accounting framework such as IFRS or ASPE.
B. The information used by a Canada Revenue Agency auditor is the financial information in the auditee's federal tax return. The criteria are 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.
- 7) A
- 8) D
- 9) 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.
- 10) Factors:
 1. Risk-free interest rate: The rate the bank could earn in a risk-free investment such as Canada Treasury bills.
 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 decisions are made were inaccurate.

Audits impact information risk. Having a set of audited financial statements can reduce the information risk and increase the likelihood that the bank will make the loan and even at a reduced interest rate due to the reliance it can place on the audited financial statements.

- 11) D
- 12) C
- 13) First, the concept of a competent, independent person requires that the practitioner who is conducting an assurance engagement should have "adequate proficiency," which means that the tax auditor should be competent in the fields of taxation and the fields that need to be assessed, such as accounting, information systems, data management and access and internal controls. The auditor should also use due care and have an objective state of mind. This means that the auditor should be independent of the client and do their best using their skills when conducting the audit.

The second part of Figure 1-2 relates to the accumulation and evaluation of evidence using a risk-based approach. This means that the auditor would collect evidence based upon risks of violations in the tax return by the client.

The next three parts are connected. The auditor determines the correspondence of the information provided by the client (which could be the financial statements, tax return and the quality of the calculations within the tax return) to established criteria (the *Income Tax Act*).

Finally, the auditor issues a report (Notice of Assessment) to summarize the findings.

Answer Key

Testname: CH01

- 14) A. Yes, the PA 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 the PA 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, the PA 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 your sister why she wants you to prepare the tax returns (Does she just want to save some money? Or is she trying to prepare tax returns that are fraudulent?). It would be inappropriate (and professionally dangerous) to be associated with false and misleading information, as one could be sued by the tax department and expelled from the profession.
- 15) C
16) D
17) A
18) B
- 19) Public Accountants: Primary function is the audit of financial statements of publicly traded companies and of other organizations requiring audits. 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 the audit of financial statements, the auditor must be a licensed public accountant.
Government Auditors: Primary function is the audit of ministries, departments, and agencies that 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 audits.
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 reporting their findings directly to the board of directors and audit committee. The internal auditor must be independent from the line function in the organization he/she is auditing.
- 20) C
21) B
22) B
23) C
24) D
- 25) 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, 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 LSP has older manufacturing equipment than Mega, LSP 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.
- 26) B
27) A
28) C
29) D
30) D
31) C
32) D

Answer Key

Testname: CH01

- 33) B
- 34) A
- 35) D
- 36) B
- 37) C
- 38) B
- 39) B
- 40) C
- 41) C
- 42) B
- 43) C
- 44) C
- 45) D
- 46) B
- 47) B
- 48) B
- 49) D
- 50) D
- 51) A
- 52) A
- 53) B
- 54) A
- 55) B
- 56) D
- 57) D
- 58) C
- 59) 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 thorough understanding of the principles and rules that provide the basis for preparing the accounting information. In addition, accountants also help to develop systems to ensure that the entity's economic events are properly recorded in a timely manner and at a reasonable cost.

The role of auditors is to determine whether the recorded financial information prepared by accountants reasonably 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.

- 60) A
- 61) A
- 62) A
- 63) A
- 64) A
- 65) B
- 66) D
- 67) D
- 68) C
- 69) A
- 70) D
- 71) B
- 72) C
- 73) A

Answer Key

Testname: CH01

- 74) 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, and would also show the assets, liabilities, and any surplus/deficit are reported in the proper entity and have not been reported or used in the wrong entity.
- 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 prepare tax returns and any regulatory filings. They could assist the foundation in obtaining working capital funding for the new drop-in centre, if needed.