

Chapter 02_7e

Student: _____

1. According to generally accepted auditing standards (GAAS), the overall objective of a financial statement audit is _____.
A to enable the auditor to express an opinion as to whether the financial statements are prepared in
 . accordance with generally accepted accounting principles
B. to reduce audit risk to an acceptably low level
C. to determine whether the financial principles adopted by management in preparing the financial
 statements are acceptable
D to obtain reasonable assurance that the financial statements taken as a whole are free from
 . misstatement, whether due to fraud or error
2. Which of the following is the first task that the auditor must accomplish to demonstrate proficiency in auditing?
A Identify the evidence relevant for the audit of assertions that are made by management in its unaudited
 . financial statements and notes.
B Design an audit program to obtain sufficient appropriate evidence about assertions management makes
 . in financial statements and notes.
C. Recognize the underlying assertions made by management in the financial statements and notes.
D Evaluate the evidence gathered in the performance of the audit program and decide whether
 . management's assertions conform to generally accepted accounting principles and reality.
3. Auditors try to achieve independence in appearance in order to _____.
A. maintain public confidence in the profession
B. become independent in appearance and in fact
C. comply with the generally accepted auditing standards
D. maintain an unbiased mental attitude
4. Control risk is _____.
A the probability that a material misstatement could occur and not be prevented or detected by the
 . company's internal control policies and procedures
B. the probability that a material misstatement could occur and not be detected by the auditor's audit
 procedures
C. the risk that the auditor will not be able to complete the audit on a timely basis
D. the risk that the auditor will not properly control the staff on the audit engagement
5. The primary purpose of obtaining an understanding of the company's internal controls in the financial statement audit is _____.
A. to help the auditors develop the audit program
B. to make suggestions to management to improve internal controls
C. to obtain direct sufficient appropriate audit evidence to afford a reasonable basis for an opinion on the
 financial statements
D. to determine whether the company has changed any accounting principles
6. An external auditor is conducting an audit of the financial statements of Camden Corporation. The external auditor is expected to _____.
A. certify the correctness of Camden's financial statements
B. make a 100% examination of Camden's records
C. give an opinion on whether Camden's financial statements are fairly presented in all material respects
D give an opinion on the attractiveness of Camden for investment purposes and critique the wisdom and
 . legality of its business decisions

7. Which of the following statements best explains an unmodified report opinion?
- A. The financial statements contain a departure from GAAP.
 - B. The auditor was unable to complete the work necessary to form a complete opinion.
 - C. The auditor was not aware of any reasons not to believe the statements are correct.
 - D. Based on the evidence obtained, the auditor believes the statements are free of material error.
8. A standard unmodified audit report should be dated _____.
- A. no later than the date when the auditor obtained sufficient appropriate audit evidence supporting the auditor's opinion
 - B. no earlier than the date when the auditor obtained sufficient appropriate audit evidence supporting the auditor's opinion
 - C. as at the end of the year being reported on
 - D. as at the end of the year the audit work was done
9. Several sources of GAAP consulted by an auditor are in conflict as to the application of an accounting principle. Which of the following should the auditor consider to be the most authoritative?
- A. *CPA Canada Handbook*.
 - B. *CPA Canada Exposure Drafts*.
 - C. Industry practice.
 - D. Federal legislation.
10. The reporting standards require that the auditor explicitly report on whether the financial statements _____.
- A. contain adequate disclosure of all material matters
 - B. are in accordance with GAAP
 - C. used principles that are appropriate for the circumstances
 - D. were prepared on a consistent basis with the comparative year
11. Because of the risk of material misstatement, an audit of financial statements in accordance with generally accepted auditing standards should be planned and performed with an attitude of _____.
- A. objective judgment
 - B. independent integrity
 - C. professional skepticism
 - D. impartial conservatism
12. Three-Party Accountability includes all of the following parties except _____.
- A. users
 - B. practitioners
 - C. Audit Committee
 - D. management
13. Key features of SOX include all of the following except _____.
- A. increased penalties for corporate wrongdoers
 - B. more timely and extensive financial disclosures
 - C. fewer options of recourse for aggrieved shareholders
 - D. increased oversight of auditors
14. Which of the following has been established to oversee the auditors of public companies?
- A. Canadian Coalition for Good Governance.
 - B. Canadian Public Accountability Board.
 - C. The SOX Board.
 - D. The Canadian Securities Commission.

15. An assurance engagement is one in which a CPA is engaged to _____.
- A. issue a written communication expressing a conclusion concerning a subject matter for which an accountable party is responsible
 - B. provide tax advice or prepare a tax return based on financial information the CPA has not audited or reviewed
 - C. testify as an expert witness in accounting, auditing, or tax matters, given certain stipulated facts
 - D. assemble prospective financial statements based on the assumptions of the entity's management without expressing any assurance
16. All of the following are examples of assurance engagements except _____.
- A. tax planning
 - B. financial statements audit
 - C. internal controls statement
 - D. financial statements review
17. The GAAS general standard relating to the audit of financial statements focuses on all of the following except _____.
- A. competence
 - B. independence
 - C. due professional care
 - D. planning
18. According to IFAC, which of the following is not one of the elements of quality control?
- A. Independence.
 - B. Supervision.
 - C. Acceptance and continuance of clients.
 - D. Due professional care.
19. In establishing a quality control system, which area should be of a secondary nature?
- A. Creating an independence and objectivity checklist.
 - B. Creating a program for continuing professional education.
 - C. Creating an internal review process.
 - D. Controlling access to client files.
20. Williams & Co., a large international CPA firm, will be subject to an external peer review. The peer review will most likely be performed by _____.
- A. employees and partners of Williams & Co. who are not associated with the particular audits being reviewed
 - B. employees and partners of another CPA firm
 - C. peer review staff of the Ontario Securities Commission
 - D. peer review staff of CPA Canada
21. A report giving conclusions about a firm's compliance with quality control standards is typical of which of the following?
- A. Practice inspection.
 - B. Quality inspection.
 - C. Peer review.
 - D. Quality review.
22. Practice standards are a general set of standards intended to guide the audits of financial statements.
True False
23. The *CPA Canada Handbook* recommendations are a step-by-step list of procedures auditors have to complete for each engagement.
True False
24. The general standard of GAAS relates primarily to the personal integrity and professional qualifications of auditors.
True False

25. Control risk is the risk that an accounting firm's quality control standards will not be adequate.
True False
26. The fourth reporting standard requires the audit report to comment on the consistency of the accounting principles used in preparing the financial statements.
True False
27. Audit risk is the risk that an auditor expresses an inappropriate audit opinion when the financial statements are materially misstated.
True False
28. Reliance on self-regulation of the accounting profession has changed as a result of its perceived failure to detect the problems leading to the corporate scandals of 2002/2003.
True False
29. Appropriate audit evidence, to be reliable and relevant, must be quantitative, objective, and absolutely compelling.
True False
30. A prospectus is the information, usually including financial information, about a firm that accompanies any new issuance of shares in a regulated securities market.
True False
31. The assessment of materiality has a pervasive impact on the audit.
True False
32. Audit committees monitor management's financial reporting responsibilities.
True False
33. Practice inspection is something a new auditor does as part of his or her training program.
True False

34. Alan Fallon was recently promoted to senior accountant. He was put in charge of the Mellow Markets audit because of his experience with other grocery clients. Mellow Markets has a small, but growing chain of natural food stores. This is the first year Mellow Markets has been audited. Because of its growth, Mellow needs additional capital. Mellow intends to take its audited financial statements to a bank to secure a loan.

Alan has been assigned two inexperienced staff assistants for the audit. Because this is his first audit as a senior, he intends to bring the job in on budget. To save time, he gave the assistants the audit program for Happy Time Food Stores. He told his staff that this would make things go more quickly. He also told them that he could not spend much time with them at the client's place of business because "my time is billed out at such a high rate, we'll go right over budget." He did call them once a day from another audit on which he was working. The assistants told Alan that the audit program did not always match up with what they found at Mellow Markets. Alan responded, "Just cross out whatever is not relevant in the audit program and don't add anything-it will only make us go over the budget."

When Alan came out near the end of fieldwork, one assistant communicated her concern that they had not attended the inventory counts at any of the out-of-town locations of Mellow Markets. The audit program had stipulated that inventory should be observed for in-town stores only. Happy Time had only one store not in town while Mellow Markets had three of their five stores in other cities. Alan told the assistant to get inventory sheets from the client for the other stores. He added, "Make sure that the inventory balance in the general ledger agrees with the total for all the inventory sheets." The next day, Alan reviewed all work papers and submitted the job for review by the manager.

Required:

- A. Describe three GAAS examination standards.
- B. Do you believe that the Mellow Markets audit is in compliance with these standards? Explain.

35. What is the difference between audit procedures and audit standards?

36. What is a quality inspection?

Chapter 02_7e Key

1. A
2. C
3. A
4. A
5. A
6. C
7. D
8. B
9. A
10. B
11. C
12. C
13. C
14. B
15. A
16. A
17. D
18. D
19. C
20. B
21. C
22. TRUE
23. FALSE
24. TRUE
25. FALSE
26. FALSE
27. TRUE
28. TRUE
29. FALSE
30. TRUE
31. TRUE
32. TRUE
33. FALSE

3. The third examination standard also seems to have been violated. First, the deficiencies in meeting the first two examination standards suggest that the auditors could not have obtained sufficient appropriate evidence. In addition, the failure to observe any of the inventory counts in other cities is an additional deficiency-particularly since Mellow is a new client. Finally, ensuring that the inventory sheets agree with the balance in the general ledger account is merely a first step in the audit of inventory. By itself it is not sufficient appropriate evidence.

2. There is no indication of any steps taken to understand, evaluate, or test the internal control of Mellow Markets. This is a violation of the second examination standard.

1. The Mellow Markets audit is not in compliance with these standards. A proper audit program was not prepared. This, along with the emphasis on cutting time, means that it is also doubtful that a meaningful knowledge of the client's business was obtained. It appears that the planning portion of the first examination standard was clearly violated. The lack of time and attention the inexperienced staff received from Alan Fallon is indicative of a violation of the supervision part of the first examination standard.

B.

3. Sufficient appropriate audit evidence should be obtained, by such means as inspection, observation, enquiry, confirmation, computation, and analysis, to afford a reasonable basis to support the content of the report.

2. A sufficient understanding of internal control should be obtained to plan the audit. When control risk is assessed below maximum, sufficient appropriate audit evidence should be obtained through tests of controls to support the assessment.

1. The work should be adequately planned and properly executed using sufficient knowledge of the entity's business as a basis. If assistants are employed, they should be properly supervised.

The examination standards are outlined below.

34. **A.**

35. Audit standards are audit-quality recommendations that remain the same over time for all audits. Audit procedures, on the other hand, are quite different and include the particular specialized actions auditors take to obtain evidence in a specific audit engagement.

36. A quality inspection is an examination and evaluation of the quality of the overall practice. It is thus aimed at the firm level rather than at individuals. It involves extensive study of a firm's quality control document and includes interviews with audit personnel as well as a detailed study of the quality of work, adherence to GAAS, and quality control standards on a selection of audit engagements.

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