

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

- 1) According to generally accepted auditing standards (GAAS), the overall objective of a financial statement audit is \_\_\_\_\_.
- A) to obtain reasonable assurance that the financial statements taken as a whole are free from misstatement, whether due to fraud or error
  - B) to determine whether the financial principles adopted by management in preparing the financial statements are acceptable
  - C) to enable the auditor to express an opinion as to whether the financial statements are prepared in accordance with generally accepted accounting principles
  - D) to reduce audit risk to an acceptably low level

Answer: C

- 2) Which of the following is the first task that the auditor must accomplish to demonstrate proficiency in auditing?
- A) Design an audit program to obtain sufficient appropriate evidence about assertions management makes in financial statements and notes.
  - B) Recognize the underlying assertions made by management in the financial statements and notes.
  - C) Identify the evidence relevant for the audit of assertions that are made by management in its unaudited 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.

Answer: B

- 3) Auditors try to achieve independence in appearance in order to \_\_\_\_\_.
- A) comply with the generally accepted auditing standards
  - B) maintain public confidence in the profession
  - C) maintain an unbiased mental attitude
  - D) become independent in appearance and in fact

Answer: B

- 4) Control risk is \_\_\_\_\_.
- A) the probability that a material misstatement could occur and not be detected by the auditor's audit procedures
  - B) the risk that the auditor will not be able to complete the audit on a timely basis
  - C) the probability that a material misstatement could occur and not be prevented or detected by the company's internal control policies and procedures
  - D) the risk that the auditor will not properly control the staff on the audit engagement

Answer: C

- 5) The primary purpose of obtaining an understanding of the company's internal controls in the financial statement audit is \_\_\_\_\_.
- A) to obtain direct sufficient appropriate audit evidence to afford a reasonable basis for an opinion on the financial statements
  - B) to determine whether the company has changed any accounting principles
  - C) to make suggestions to management to improve internal controls
  - D) to help the auditors develop the audit program

Answer: D

- 6) An external auditor is conducting an audit of the financial statements of Camden Corporation. The external auditor is expected to \_\_\_\_\_.
- A) give an opinion on whether Camden's financial statements are fairly presented in all material respects
  - B) give an opinion on the attractiveness of Camden for investment purposes and critique the wisdom and legality of its business decisions
  - C) certify the correctness of Camden's financial statements
  - D) make a 100% examination of Camden's records

Answer: A

- 7) Which of the following statements best explains an unmodified report opinion?
- A) The auditor was unable to complete the work necessary to form a complete opinion.
  - B) The auditor was not aware of any reasons not to believe the statements are correct.
  - C) Based on the evidence obtained, the auditor believes the statements are free of material error.
  - D) The financial statements contain a departure from GAAP.

Answer: C

- 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) as at the end of the year the audit work was done
  - C) as at the end of the year being reported on
  - D) no earlier than the date when the auditor obtained sufficient appropriate audit evidence supporting the auditor's opinion

Answer: D

- 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 Exposure Drafts.*
  - B) Industry practice.
  - C) *CPA Canada Handbook.*
  - D) Federal legislation.

Answer: C

- 10) The reporting standards require that the auditor explicitly report on whether the financial statements \_\_\_\_\_.
- A) used principles that are appropriate for the circumstances
  - B) were prepared on a consistent basis with the comparative year
  - C) are in accordance with GAAP
  - D) contain adequate disclosure of all material matters

Answer: C

- 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) independent integrity
  - B) professional skepticism
  - C) impartial conservatism
  - D) objective judgment

Answer: B

- 12) Three-Party Accountability includes all of the following parties except \_\_\_\_\_.
- A) users
  - B) management
  - C) Audit Committee
  - D) practitioners

Answer: C

- 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) increased oversight of auditors
  - D) fewer options of recourse for aggrieved shareholders

Answer: D

- 14) Which of the following has been established to oversee the auditors of public companies?
- A) The Canadian Securities Commission.
  - B) Canadian Public Accountability Board.
  - C) The SOX Board.
  - D) Canadian Coalition for Good Governance.

Answer: B

- 15) An assurance engagement is one in which a CPA is engaged to \_\_\_\_\_.
- A) testify as an expert witness in accounting, auditing, or tax matters, given certain stipulated facts
  - B) provide tax advice or prepare a tax return based on financial information the CPA has not audited or reviewed
  - C) issue a written communication expressing a conclusion concerning a subject matter for which an accountable party is responsible
  - D) assemble prospective financial statements based on the assumptions of the entity's management without expressing any assurance

Answer: C

- 16) All of the following are examples of assurance engagements except \_\_\_\_\_.
- A) financial statements review
  - B) internal controls statement
  - C) tax planning
  - D) financial statements audit

Answer: C

- 17) The GAAS general standard relating to the audit of financial statements focuses on all of the following except \_\_\_\_\_.
- A) due professional care
  - B) competence
  - C) planning
  - D) independence

Answer: C

- 18) According to IFAC, which of the following is not one of the elements of quality control?
- A) Supervision.
  - B) Acceptance and continuance of clients.
  - C) Independence.
  - D) Due professional care.

Answer: D

- 19) In establishing a quality control system, which area should be of a secondary nature?
- A) Creating an independence and objectivity checklist.
  - B) Controlling access to client files.
  - C) Creating an internal review process.
  - D) Creating a program for continuing professional education.

Answer: C

- 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) peer review staff of CPA Canada
  - C) peer review staff of the Ontario Securities Commission
  - D) employees and partners of another CPA firm

Answer: D

- 21) A report giving conclusions about a firm's compliance with quality control standards is typical of which of the following?
- A) Quality inspection.
  - B) Quality review.
  - C) Practice inspection.
  - D) Peer review.

Answer: D

**TRUE/FALSE. Write 'T' if the statement is true and 'F' if the statement is false.**

- 22) Practice standards are a general set of standards intended to guide the audits of financial statements.

Answer:  True       False

- 23) The *CPA Canada Handbook* recommendations are a step-by-step list of procedures auditors have to complete for each engagement.

Answer:  True       False

- 24) The general standard of GAAS relates primarily to the personal integrity and professional qualifications of auditors.  
Answer:  True  False
- 25) Control risk is the risk that an accounting firm's quality control standards will not be adequate.  
Answer:  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.  
Answer:  True  False
- 27) Audit risk is the risk that an auditor expresses an inappropriate audit opinion when the financial statements are materially misstated.  
Answer:  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.  
Answer:  True  False
- 29) Appropriate audit evidence, to be reliable and relevant, must be quantitative, objective, and absolutely compelling.  
Answer:  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.  
Answer:  True  False
- 31) The assessment of materiality has a pervasive impact on the audit.  
Answer:  True  False
- 32) Audit committees monitor management's financial reporting responsibilities.  
Answer:  True  False
- 33) Practice inspection is something a new auditor does as part of his or her training program.  
Answer:  True  False

**SHORT ANSWER. Write the word or phrase that best completes each statement or answers the question.**

- 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 senior, he intends to bring the job in on budget. To save time, he gave the assistants the audit program 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 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 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 he 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.

Answer: **A.**

The examination standards are outlined below.

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

**B.**

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 sufficient understanding 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.
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.
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.

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

Answer: 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) What is a quality inspection?

Answer: 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.

## Answer Key

Testname: UNTITLED2

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



Answer Key

Testname: UNTITLED2

34) **A.**

The examination standards are outlined below.

1. The work should be adequately planned and properly executed using sufficient knowledge of the entity's as a basis. If assistants are employed, they should be properly supervised.
2. A sufficient understanding of internal control should be obtained to plan the audit. When control risk is below maximum, sufficient appropriate audit evidence should be obtained through tests of controls to support assessment.
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.

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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 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 failure of the supervision part of the first examination standard.
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- 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.