

CHAPTER 1

INTRODUCTION AND OVERVIEW OF AUDIT AND ASSURANCE

CHAPTER LEARNING OBJECTIVES

1. Define an assurance engagement.

An assurance engagement involves an assurance provider arriving at an opinion about some information being provided by their client to a third party. A financial statement audit is one type of assurance engagement. This engagement involves an auditor arriving at an opinion about the fair presentation of the financial statements. The audit report is addressed to the shareholders of the company being audited, but other users may read the financial statements. Learning about auditing and assurance requires an understanding of auditing and assurance terminology, including terms such as audit risk, materiality, internal controls, listed entity, and assertions.

2. Explain why there is a demand for audit and assurance services.

Financial statement users include investors (shareholders), suppliers, customers, lenders, employees, governments, and the general public. These groups of users demand audited financial statements because of their remoteness from the entity, accounting complexity, their incentives competing with those of the entity's managers, and their need for reliable information on which to base decisions. The theories used to describe the demand for audit and assurance services are agency theory, the information hypothesis, and the insurance hypothesis.

3. Differentiate between types of assurance services.

Assurance services include financial statement audits, compliance audits, performance audits, comprehensive audits, internal audits, and assurance on corporate social responsibility (CSR) disclosures.

4. Explain the different levels of assurance.

The different levels of assurance include reasonable assurance, which is the highest level of assurance, limited assurance, and no assurance. Reasonable assurance is provided on an audit of a company's financial statements. Limited assurance is provided in a review of a company's financial statements. No assurance is provided in a compilation engagement.

5. Outline different audit opinions

An auditor can issue an unmodified opinion, also known as a clean report, or an unmodified opinion with an emphasis of matter paragraph. Alternatively, a modified opinion may be issued as a qualified, an adverse, or a disclaimer of opinion.

6. Differentiate between the roles of the preparer and the auditor, and discuss the different firms that provide assurance services.

It is the responsibility of a company's governing body to ensure that its financial statements are relevant, reliable, comparable, understandable, and true and fair. It is the responsibility of the auditor to form an opinion on the fair presentation of the financial statements. In doing,

so the auditor must maintain professional scepticism and utilize professional judgement and due care.

The firms that provide assurance services include the Big-4 international firms, the national firms (with international links), local and regional firms, and consulting firms that tend to specialize in assurance of CSR and environmental disclosures.

7. Identify the different regulators, legislation, and regulations surrounding the assurance process.

Regulators of the assurance process include the Auditing and Assurance Standards Board (AASB), Canadian Securities Administrators (CSA) and the various provincial securities commissions, and the Canadian Public Accountability Board (CPAB). Relevant legislation includes the Canada Business Corporations Act (CBCA). CPA Canada is the professional accounting body in Canada, responsible for the Chartered Professional Accountant (CPA) designation.

8. Describe the audit expectation gap.

The audit expectation gap occurs when there is a difference between the expectations of assurance providers and financial statement or other users. The gap occurs when user beliefs do not align with what an auditor has actually done.

TRUE-FALSE STATEMENTS

1. Only current investors (not potential investors) are considered to be users of the financial statements.

Answer: False

Bloomcode: Knowledge

Difficulty: Easy

Learning Objective: Explain why there is a demand for audit and assurance services.

Section Reference: 1.2 Demand for audit and assurance services

CPA Competency: Audit and Assurance

AACSB: Analytic

2. Insurance hypothesis is a means whereby the investor can guarantee the success of their investment.

Answer: False

Bloomcode: Comprehension

Difficulty: Medium

Learning Objective: Explain why there is a demand for audit and assurance services.

Section Reference: 1.2 Demand for audit and assurance services

CPA Competency: Audit and Assurance

AACSB: Analytic

3. A compliance audit involves gathering evidence to ascertain whether the person or entity under review has followed the rules, policies, procedures, laws and regulations with which they must conform

Answer: True

Bloomcode: Comprehension

Difficulty: Medium

Learning Objective: Differentiate between types of assurance services.

Section Reference: 1.3 Different assurance services

CPA Competency: Audit and Assurance

AACSB: Analytic

4. An operational audit is an example of a compliance audit.

Answer: False

Bloomcode: Knowledge

Difficulty: Medium

Learning Objective: Differentiate between types of assurance services.

Section Reference: 1.3 Different assurance services

CPA Competency: Audit and Assurance

AACSB: Analytic

5. The most common types of assurance engagements are financial statement audits, confirmation audits, performance audits, comprehensive audits and assurance on corporate social responsibility (CSR) disclosures.

Answer: False

Bloomcode: Comprehension

Difficulty: Medium

Learning Objective: Differentiate between types of assurance services.

Section Reference: 1.3 Different assurance services

CPA Competency: Audit and Assurance

AACSB: Analytic

6. The nature of audit procedures refers to the reliance on evidence provided by the client and its management.

Answer: True

Bloomcode: Knowledge

Difficulty: Medium

Learning Objective: Differentiate between types of assurance services.

Section Reference: 1.3 Different assurance services

CPA Competency: Audit and Assurance

AACSB: Analytic

7. It is the auditor's responsibility to prepare the financial statements.

Answer: False

Bloomcode: Knowledge

Difficulty: Medium

Learning Objective: Differentiate between types of assurance services.

Section Reference: 1.3 Different assurance services

CPA Competency: Audit and Assurance

AACSB: Analytic

8. An auditor can provide a reasonable level of assurance on information other than historical financial information.

Answer: True

Bloomcode: Comprehension

Difficulty: Easy

Learning Objective: Explain the different levels of assurance.

Section Reference: 1.4 Different levels of assurance

CPA Competency: Audit and Assurance

AACSB: Analytic

9. A reasonable level of assurance is the highest level of assurance that an auditor can provide.

Answer: True

Bloomcode: Comprehension

Difficulty: Medium

Learning Objective: Explain the different levels of assurance.

Section Reference: 1.4 Different levels of assurance

CPA Competency: Audit and Assurance

AACSB: Analytic

10. A no assurance engagement is of little use as no assurance is given to the client.

Answer: False

Bloomcode: Comprehension

Difficulty: Medium

Learning Objective: Explain the different levels of assurance.

Section Reference: 1.4 Different levels of assurance

CPA Competency: Audit and Assurance

AACSB: Analytic

11. A negative expression of opinion is only given when there is a disagreement with management and the auditor.

Answer: False

Bloomcode: Knowledge

Difficulty: Medium

Learning Objective: Outline different audit opinions.

Section Reference: 1.5 Different audit opinions

CPA Competency: Audit and Assurance

AACSB: Analytic

12. All modified audit reports are qualified audit opinions.

Answer: False

Bloomcode: Knowledge

Difficulty: Medium

Learning Objective: Outline different audit opinions.

Section Reference: 1.5 Different audit opinions

CPA Competency: Audit and Assurance

AACSB: Analytic

13. The expectation gap is caused by unrealistic user expectations such as the auditor providing a moderate level of assurance.

Answer: False

Bloomcode: Comprehension

Difficulty: Medium

Learning Objective: Describe the audit expectation gap.

Section Reference: 1.8 The audit expectation gap

CPA Competency: Audit and Assurance

AACSB: Analytic

MULTIPLE CHOICE QUESTIONS

14. Martha Minnati was reviewing the previous year's audited financial statements of a clothing manufacturer. Her manager explained to her that for a financial statement audit, the clothing company was the accountable party, its shareholders were the users, and the subject matter was the financial statements. What kind of audit engagement was her manager describing?

- a) consulting engagement
- b) assurance engagement
- c) review engagement
- d) compliance engagement

Answer: b

Bloomcode: Comprehension

Difficulty: Easy

Learning Objective: Define an assurance engagement.

Section Reference: 1.1 Auditing and assurance defined

CPA Competency: Audit and Assurance

AACSB: Analytic

15. An engagement performed by an auditor or consultant to enhance the reliability of the subject matter can best be described as a(n)

- a) compilation engagement.
- b) review engagement.
- c) consultancy engagement.
- d) assurance engagement.

Answer: d

Bloomcode: Comprehension

Difficulty: Medium

Learning Objective: Define an assurance engagement.

Section Reference: 1.1 Auditing and assurance defined

CPA Competency: Audit and Assurance

AACSB: Analytic

16. An example of the three parties in an assurance engagement would be:

- a) audit client, employee, customer.
- b) audit client, supplier, auditor.
- c) auditor, shareholder, general public.
- d) auditor, general public, employees.

Answer: b

Bloomcode: Knowledge

Difficulty: Medium

Learning Objective: Define an assurance engagement.

Section Reference: 1.1 Auditing and assurance defined
CPA Competency: Audit and Assurance
AACSB: Analytic

17. A limitation of an audit is caused by

- a) the nature of financial reporting.
- b) the nature of audit procedures.
- c) the need for the audit to be conducted within a reasonable period of time and at a reasonable cost.
- d) all of the above

Answer: d

Bloomcode: Comprehension
Difficulty: Medium
Learning Objective: Define an assurance engagement.
Section Reference: 1.1 Auditing and assurance defined
CPA Competency: Audit and Assurance
AACSB: Analytic

18. Which of the following groups would be considered users of the financial statements?

- a) governments
- b) current shareholders
- c) general public
- d) all of the above

Answer: d

Bloomcode: Comprehension
Difficulty: Medium
Learning Objective: Explain why there is a demand for audit and assurance services.
Section Reference: 1.2 Demand for audit and assurance services
CPA Competency: Audit and Assurance
AACSB: Analytic

19. The sources of demand for audit and assurance services does **not** include

- a) independence.
- b) complexity.
- c) reliability.
- d) competing incentives.

Answer: a

Bloomcode: Comprehension
Difficulty: Medium
Learning Objective: Explain why there is a demand for audit and assurance services.
Section Reference: 1.2 Demand for audit and assurance services
CPA Competency: Audit and Assurance
AACSB: Analytic

20. An audit is one way for investors to insure against at least part of their loss should the company they invest in fail – this is an example of

- a) agency theory.
- b) information hypothesis.
- c) insurance hypothesis.
- d) competing incentives.

Answer: c

Bloomcode: Comprehension

Difficulty: Medium

Learning Objective: Explain why there is a demand for audit and assurance services.

Section Reference: 1.2 Demand for audit and assurance services

CPA Competency: Audit and Assurance

AACSB: Analytic

21. According to the agency theory, demand for audit is due to conflicts between

- a) managers and owners.
- b) managers and agents.
- c) owners and principals.
- d) auditors and owners.

Answer: a

Bloomcode: Knowledge

Difficulty: Medium

Learning Objective: Explain why there is a demand for audit and assurance services.

Section Reference: 1.2 Demand for audit and assurance services

CPA Competency: Audit and Assurance

AACSB: Analytic

22. While awaiting a meeting in his firm's boardroom, the senior partner, Bill Goldsworthy, read the following statement in an article in the Globe & Mail: "The greater the perceived quality of the information contained in the financial statements, the more likely it will be relied upon by the users of that information." This statement best describes

- a) the expectations gap.
- b) agency theory.
- c) information hypothesis.
- d) insurance hypothesis.

Answer: c

Bloomcode: Comprehension

Difficulty: Medium

Learning Objective: Explain why there is a demand for audit and assurance services.

Section Reference: 1.2 Demand for audit and assurance services

CPA Competency: Audit and Assurance

AACSB: Analytic

23. As users of the financial statements, suppliers would least consider which of the following aspects of the financial statements?

- a) solvency of the entity
- b) profitability of the entity
- c) return on investment of the entity
- d) corporate social responsibility of the entity

Answer: c

Bloomcode: Comprehension

Difficulty: Easy

Learning Objective: Explain why there is a demand for audit and assurance services.

Section Reference: 1.2 Demand for audit and assurance services

CPA Competency: Audit and Assurance

AACSB: Analytic

24. Which of the following is **incorrect**? A government can be considered to be a user of the general purpose financial statements because

- a) it is the basis for the calculation of taxes owed to the government.
- b) it can determine whether certain regulations have been complied with.
- c) to gain a better understanding of the entity's activities.
- d) governments need to assess the entity so that they can provide the entity with grants that will benefit society.

Answer: a

Bloomcode: Comprehension

Difficulty: Medium

Learning Objective: Explain why there is a demand for audit and assurance services.

Section Reference: 1.2 Demand for audit and assurance services

CPA Competency: Audit and Assurance

AACSB: Analytic

25. Agency theory can be described as the theory of

- a) hiring an agency to review the work of the management, in this case it is the auditor.
- b) when the finance function is outsourced to an outside party, and the auditor is required to audit the outside party's work.
- c) the relationship between the owner and the management of the business when the owner is not the manager of the business.
- d) none of the above

Answer: c

Bloomcode: Comprehension

Difficulty: Medium

Learning Objective: Explain why there is a demand for audit and assurance services.

Section Reference: 1.2 Demand for audit and assurance services

CPA Competency: Audit and Assurance
AACSB: Analytic

26. Insurance hypothesis tells us that

- a) investors will demand that financial statements be audited as a way of insuring against some of their loss should their investment fail.
- b) investors can insure themselves against loss by investing in a diverse investment portfolio should an individual investment fail.
- c) investors cannot insure themselves against loss when investing in an entity.
- d) the entity can take out insurance to protect itself from such risks as employee or management fraud which can lead to material misstatements in the financial statements.

Answer: a

Bloomcode: Comprehension

Difficulty: Medium

Learning Objective: Explain why there is a demand for audit and assurance services.

Section Reference: 1.2 Demand for audit and assurance services

CPA Competency: Audit and Assurance

AACSB: Analytic

27. Vera Sobczyk spent a week at a client's wholesale operation determining whether the client's remittances to the tax authorities were in accordance with tax regulations. This is an example of a(n)

- a) taxes payable mandate.
- b) financial audit.
- c) operational audit.
- d) none of the above

Answer: d

Bloomcode: Comprehension

Difficulty: Medium

Learning Objective: Differentiate between types of assurance services.

Section Reference: 1.3 Different assurance services

CPA Competency: Audit and Assurance

AACSB: Analytic

28. Ming Yao reviewed the operations of a basketball academy. His objectives were to determine how effectively the academy delivered its many programs. What kind of an audit did he perform?

- a) operational
- b) compliance
- c) financial
- d) comprehensive

Answer: a

Bloomcode: Comprehension

Difficulty: Medium

Learning Objective: Differentiate between types of assurance services.

Section Reference: 1.3 Different assurance services

CPA Competency: Audit and Assurance

AACSB: Analytic

29. Matt Fuller reports to the board and evaluates how the company can improve risk management practices, internal control procedures, and certain governance issues. Who is he?

- a) President
- b) Controller
- c) Treasurer
- d) Internal Auditor

Answer: d

Bloomcode: Comprehension

Difficulty: Medium

Learning Objective: Differentiate between types of assurance services.

Section Reference: 1.3 Different assurance services

CPA Competency: Audit and Assurance

AACSB: Analytic

30. Which of the following is **not** true about Corporate Social Responsibility assurance?

- a) reporting is voluntary and is becoming more widespread
- b) includes both financial and non-financial information
- c) is required to be performed by an auditor
- d) disclosures include environmental, employee and social reporting

Answer: c

Bloomcode: Knowledge

Difficulty: Medium

Learning Objective: Differentiate between types of assurance services.

Section Reference: 1.3 Different assurance services

CPA Competency: Audit and Assurance

AACSB: Analytic

31. Michael Stiller performed work for a client in the real estate business and issued a Notice to Reader. What degree of assurance does a Notice to Reader provide to the user of the statements?

- a) reasonable assurance
- b) moderate assurance
- c) no assurance
- d) none of the above

Answer: c

Bloomcode: Comprehension

Difficulty: Easy

Learning Objective: Explain the different levels of assurance.

Section Reference: 1.4 Different levels of assurance

CPA Competency: Audit and Assurance

AACSB: Analytic

32. Theodore Heinrich prepared a set of financial statements based on information provided to him. He checked mathematical accuracy of the data, and the client complimented him on the reasonable cost of the work he performed. Theodore performed

- a) a compilation.
- b) a review.
- c) an audit.
- d) none of the above

Answer: a

Bloomcode: Comprehension

Difficulty: Medium

Learning Objective: Explain the different levels of assurance.

Section Reference: 1.4 Different levels of assurance

CPA Competency: Audit and Assurance

AACSB: Analytic

33. Jimmy Bunting, the senior auditor at *Yanzhou Coal Mining and Minerals*, performed the following tasks: he used analytical procedures and he had discussions with management. These activities were a basis for a conclusion on the financial information. What did Jimmy Bunting perform?

- a) a qualified report
- b) an unmodified opinion
- c) a compilation
- d) a review engagement

Answer: d

Bloomcode: Comprehension

Difficulty: Medium

Learning Objective: Explain the different levels of assurance.

Section Reference: 1.4 Different levels of assurance

CPA Competency: Audit and Assurance

AACSB: Analytic

34. Which of the following would be an example of a reasonable assurance engagement?

- a) the review of annual financial statements
- b) the audit of annual financial statements
- c) the reporting of procedures performed by the auditor as agreed by the client
- d) all of the above

Answer: b

Bloomcode: Comprehension

Difficulty: Hard

Learning Objective: Explain the different levels of assurance.

Section Reference: 1.4 Different levels of assurance

CPA Competency: Audit and Assurance

AACSB: Analytic

35. The wording of a limited assurance engagement expresses a conclusion that generally states

- a) there is nothing wrong with the subject matter.
- b) there is something wrong with the subject matter.
- c) there is nothing that has come to the attention of the auditors that would lead them to believe that the information being assured is not true and fair.
- d) there is something that has come to the attention of the auditors that would lead them to believe that the information being assured is not true and fair.

Answer: c

Bloomcode: Knowledge

Difficulty: Medium

Learning Objective: Explain the different levels of assurance.

Section Reference: 1.4 Different levels of assurance

CPA Competency: Audit and Assurance

AACSB: Analytic

36. In a review engagement, which of the following is least likely to occur during the engagement?

- a) analytical procedures
- b) enquiries with management and other personnel
- c) substantive audit procedures
- d) review of the internal controls of the entity.

Answer: c

Bloomcode: Knowledge

Difficulty: Medium

Learning Objective: Explain the different levels of assurance.

Section Reference: 1.4 Different levels of assurance

CPA Competency: Audit and Assurance

AACSB: Analytic

37. Maggie Oh performed an audit of a client that had undergone flooding to its operations in *St-Jean Sur Richelieu*. The client was insured and was able to keep operating. However, there was material damage to the client's warehouse and Maggie felt it would be appropriate to inform the users of the financial statements of this fact in the audit report. This form of audit report is called

- a) an adverse opinion.

- b) unmodified opinion – emphasis of matter.
- c) modified opinion.
- d) disclaimer of opinion.

Answer: b

Bloomcode: Comprehension

Difficulty: Medium

Learning Objective: Outline different audit opinions.

Section Reference: 1.5 Different audit opinions

CPA Competency: Audit and Assurance

AACSB: Analytic

38. Based on the evidence gathered, if an auditor concludes all noted misstatements in the financial statements to be immaterial, individually and collectively, then the auditor would

- a) resign from the engagement.
- b) emphasize the errors in the audit report.
- c) issue an unqualified opinion.
- d) issue a qualified opinion.

Answer: c

Bloomcode: Comprehension

Difficulty: Hard

Learning Objective: Outline different audit opinions.

Section Reference: 1.5 Different audit opinions

CPA Competency: Audit and Assurance

AACSB: Analytic

39. An unqualified opinion is also known as a(n)

- a) clean opinion.
- b) adverse opinion.
- c) unmodified opinion.
- d) both a and c

Answer: d

Bloomcode: Knowledge

Difficulty: Easy

Learning Objective: Outline different audit opinions.

Section Reference: 1.5 Different audit opinions

CPA Competency: Audit and Assurance

AACSB: Analytic

40. An example of an unmodified audit opinion is

- a) qualified audit opinion.
- b) adverse audit opinion.
- c) unqualified audit opinion with an emphasis of matter.

d) none of the above

Answer: c

Bloomcode: Knowledge

Difficulty: Medium

Learning Objective: Outline different audit opinions.

Section Reference: 1.5 Different audit opinions

CPA Competency: Audit and Assurance

AACSB: Analytic

41. Which of the following is **not** a type of opinion?

- a) qualified opinion
- b) modified opinion
- c) adverse opinion
- d) disclaimer of opinion

Answer: b

Bloomcode: Knowledge

Difficulty: Medium

Learning Objective: Outline different audit opinions.

Section Reference: 1.5 Different audit opinions

CPA Competency: Audit and Assurance

AACSB: Analytic

42. The following can be said about an emphasis of matter:

- a) it is included when the auditor's opinion has changed and the auditor wants to bring the users' attention to a particular matter.
- b) it is only used in unqualified audit opinions.
- c) it is included when the auditor's opinion has not changed and the auditor wants to bring the users' attention to a particular matter.
- d) it can not be used when expressing audit opinion that has pervasive misstatements.

Answer: c

Bloomcode: Comprehension

Difficulty: Medium

Learning Objective: Outline different audit opinions.

Section Reference: 1.5 Different audit opinions

CPA Competency: Audit and Assurance

AACSB: Analytic

43. A financial statement auditor is required to audit all of the following, **except**

- a) income statement and balance sheet.
- b) statement of cash flows.
- c) management discussion and analysis.
- d) notes to the financial statements.

Answer: c

Bloomcode: Comprehension

Difficulty: Medium

Learning Objective: Differentiate between the roles of the preparer and the auditor, and discuss the different firms that provide assurance services.

Section Reference: 1.6 Preparers and auditors

CPA Competency: Audit and Assurance

AACSB: Analytic

44. For a financial report to be relevant, it must

- a) be free from material misstatement.
- b) have an impact on the decisions made by users regarding the performance of the entity.
- c) be periodically audited by an independent auditor.
- d) none of the above

Answer: b

Bloomcode: Comprehension

Difficulty: Medium

Learning Objective: Differentiate between the roles of the preparer and the auditor, and discuss the different firms that provide assurance services.

Section Reference: 1.6 Preparers and auditors

CPA Competency: Audit and Assurance

AACSB: Analytic

45. For a financial report to be reliable, it must

- a) be free from material misstatement.
- b) have an impact on the decisions made by users regarding the performance of the entity.
- c) be periodically audited by an independent auditor.
- d) none of the above

Answer: a

Bloomcode: Comprehension

Difficulty: Medium

Learning Objective: Differentiate between the roles of the preparer and the auditor, and discuss the different firms that provide assurance services.

Section Reference: 1.6 Preparers and auditors

CPA Competency: Audit and Assurance

AACSB: Analytic

46. When conducting an audit, an auditor should use

- a) professional scepticism.
- b) professional judgement.
- c) due care.
- d) all of the above

Answer: d

Bloomcode: Comprehension

Difficulty: Easy

Learning Objective: Differentiate between the roles of the preparer and the auditor, and discuss the different firms that provide assurance services.

Section Reference: 1.6 Preparers and auditors

CPA Competency: Audit and Assurance

AACSB: Analytic

47. The top tier of accounting firms is comprised of

- a) Deloitte, Ernst & Young, PricewaterhouseCoopers (PwC) and KPMG.
- b) Ernst & Young, PricewaterhouseCoopers (PwC), KPMG and BDO.
- c) Deloitte, Ernst & Young, KPMG and Grant Thornton.
- d) WHK Group, Deloitte, KPMG and PricewaterhouseCoopers (PwC).

Answer: a

Bloomcode: Knowledge

Difficulty: Easy

Learning Objective: Differentiate between the roles of the preparer and the auditor, and discuss the different firms that provide assurance services.

Section Reference: 1.6 Preparers and auditors

CPA Competency: Audit and Assurance

AACSB: Analytic

48. Mary Logan was careful to undertake her audits in a most responsible manner. Her audit manager complimented her on her diligence and how well she documented her work at the different stages of the audit process. Which element of responsibility did she display?

- a) due care
- b) professional judgment
- c) professional scepticism
- d) none of the above

Answer: a

Bloomcode: Comprehension

Difficulty: Medium

Learning Objective: Differentiate between the roles of the preparer and the auditor, and discuss the different firms that provide assurance services.

Section Reference: 1.6 Preparers and auditors

CPA Competency: Audit and Assurance

AACSB: Analytic

49. Larry Dibitonto is a partner in his firm and runs management consulting, mergers and acquisitions, insolvency, tax, and accounting services. How are these services referred to collectively?

- a) audit
- b) non-assurance services

- c) reviews
- d) none of the above

Answer: b

Bloomcode: Comprehension

Difficulty: Medium

Learning Objective: Differentiate between the roles of the preparer and the auditor, and discuss the different firms that provide assurance services.

Section Reference: 1.6 Preparers and auditors

CPA Competency: Audit and Assurance

AACSB: Analytic

50. In addition to the preparation of financial statements, it is also the responsibility of those charged with governance to

- a) identify the financial reporting framework to be used in the preparation and presentation of their financial statements.
- b) establish and maintain internal controls that are effective in preventing and detecting material misstatements.
- c) selecting and applying appropriate accounting policies and making reasonable accounting estimates.
- d) all of the above

Answer: d

Bloomcode: Knowledge

Difficulty: Medium

Learning Objective: Differentiate between the roles of the preparer and the auditor, and discuss the different firms that provide assurance services.

Section Reference: 1.6 Preparers and auditors

CPA Competency: Audit and Assurance

AACSB: Analytic

51. Which of the following is **not** true in relation to comparability?

- a) able to identify trends, that may influence their perception of how well the entity is doing
- b) able to assess performance of the entity over time and with other entities
- c) able to evaluate
- d) all of the above

Answer: d

Bloomcode: Comprehension

Difficulty: Medium

Learning Objective: Differentiate between the roles of the preparer and the auditor, and discuss the different firms that provide assurance services.

Section Reference: 1.6 Preparers and auditors

CPA Competency: Audit and Assurance

AACSB: Analytic

52. Professional scepticism does **not** involve

- a) the professional requirement that all management representations be substantiated with supporting documentation.
- b) seeking independent evidence to corroborate information provided by their client
- c) being suspicious when evidence contradicts documents held by their client or enquiries made of client personnel
- d) none of the above

Answer: a

Bloomcode: Comprehension

Difficulty: Medium

Learning Objective: Differentiate between the roles of the preparer and the auditor, and discuss the different firms that provide assurance services.

Section Reference: 1.6 Preparers and auditors

CPA Competency: Audit and Assurance

AACSB: Analytic

53. The largest accounting firms in Canada are known collectively as the

- a) 'Big-3'.
- b) 'Big-4'.
- c) 'Big-5'.
- d) 'Big-6'.

Answer: b

Bloomcode: Knowledge

Difficulty: Easy

Learning Objective: Differentiate between the roles of the preparer and the auditor, and discuss the different firms that provide assurance services.

Section Reference: 1.6 Preparers and auditors

CPA Competency: Audit and Assurance

AACSB: Analytic

54. Auditors of reporting issuers are required to be a member in good standing with

- a) CPAB.
- b) CSA.
- c) CPA Canada.
- d) OSFI.

Answer: a

Bloomcode: Knowledge

Difficulty: Medium

Learning Objective: Identify the different regulators, legislation, and regulations surrounding the assurance process.

Section Reference: 1.7 The role of regulators and regulations

CPA Competency: Audit and Assurance

AACSB: Analytic

55. Under the Canada Business Corporations Act, the auditor has a responsibility to form an opinion on the company's

- a) operations.
- b) independence.
- c) financial statements.
- d) none of the above

Answer: c

Bloomcode: Knowledge

Difficulty: Easy

Learning Objective: Identify the different regulators, legislation, and regulations surrounding the assurance process.

Section Reference: 1.7 The role of regulators and regulations

CPA Competency: Audit and Assurance

AACSB: Analytic

56. The expectation gap is caused by

- a) realistic auditor expectations.
- b) unrealistic user expectations.
- c) realistic user expectations.
- d) unrealistic auditor expectations.

Answer: b

Bloomcode: Knowledge

Difficulty: Medium

Learning Objective: Describe the audit expectation gap.

Section Reference: 1.8 The audit expectation gap

CPA Competency: Audit and Assurance

AACSB: Analytic

57. The expectation gap can be reduced by

- a) auditors performing their duties properly.
- b) enhanced reporting to explain what processes have been followed in arriving at an audit or a review opinion.
- c) assurance providers reporting accurately the level of assurance being provided.
- d) all of the above

Answer: d

Bloomcode: Comprehension

Difficulty: Medium

Learning Objective: Describe the audit expectation gap.

Section Reference: 1.8 The audit expectation gap

CPA Competency: Audit and Assurance

AACSB: Analytic

58. The audit expectation gap is the difference in the expectations of the

- a) assurance providers and the financial statement users.
- b) assurance providers and the audit client.
- c) audit client and the financial report or other users.
- d) audit client and the regulator.

Answer: a

Bloomcode: Knowledge

Difficulty: Easy

Learning Objective: Describe the audit expectation gap.

Section Reference: 1.8 The audit expectation gap

CPA Competency: Audit and Assurance

AACSB: Analytic

SHORT ANSWER QUESTIONS

59. Indicate whether you agree or disagree with the following statements and explain your reasoning.

a) Maurice Lecuyer feels that an internal auditor that reports to the chief financial officer of the company can be as independent as an auditor that reports to the audit committee.

b) Jillian Humphrey discovered a very material overstatement in the financial statements of Humphrey's Holistic Medicine. She felt that the misstatement would have an impact on the decisions of users of the financial statements, and indicated to her audit senior that she would be including it as an "emphasis of matter" paragraph in the audit report.

c) An auditor is responsible for the preparation and fair presentation of the financial statements in accordance with International Financial Reporting Standards, and for such internal control as is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

d) An assurance engagement involves evaluation or measurement of subject matter against criteria.

Answer:

a) Disagree. The internal auditor's independence is protected best when they report to the highest level of governance, usually the Audit Committee of the Board or to the President of the company.

b) Disagree. The pervasiveness of the material misstatement will require an adverse opinion. In this case, the misstatements affect the financial statements materially and will require disclosures that are vital to a user's understanding of the financial statements. When statements are pervasively and materially misstated, an adverse opinion is appropriate.

c) Disagree. The above statement describes management's responsibilities. An auditor has the responsibility to express an opinion on financial statements based on an audit.

d) Agree. An assurance engagement is an engagement where a practitioner issues a written report and concludes on a subject matter for which the accountable party is responsible. Therefore, a prerequisite for an assurance engagement is the existence of an accountability relationship, where one party is answerable to another for the subject matter.

Bloomcode: Application

Difficulty: Medium

Learning Objective: Define an assurance engagement.

Learning Objective: Differentiate between types of assurance services.

Learning Objective: Explain the different levels of assurance.

Learning Objective: Differentiate between the roles of the preparer and the auditor, and discuss the different firms that provide assurance services.

Section Reference: 1.1 Auditing and assurance defined

Section Reference: 1.3 Different assurance services

Section Reference: 1.4 Different levels of assurance

Section Reference: 1.6 Preparers and auditors

CPA Competency: Auditing and Assurance

AACSB: Analytic

60. Outline the reasons for the demand for assurance services.

Answer:

Remoteness – As most users do not have access to the entity under review, this makes it difficult to determine whether the information contained in the report is a fair presentation of the entity and its activities for the relevant period.

Complexity – Most financial statement users do not have the accounting and legal knowledge to enable them to assess the complex accounting and disclosure choices being made by the entity.

Competing incentives – Management may have their own incentives to present the information in a particular light which may help them achieve their own objectives. This may introduce bias in what is being presented.

Reliability – As the information is being depended upon to make important decisions, it is important that the information being presented is reliable

Bloomcode: Comprehension

Difficulty: Medium

Learning Objective: Explain why there is a demand for audit and assurance services.

Section Reference: 1.2 Demand for audit and assurance services

CPA Competency: Auditing and Assurance

AACSB: Analytic

61. The main assurance service the general public are familiar with are financial statement audits. Briefly describe the other services that an auditor can provide.

Answer: A compliance audit involves gathering evidence to ascertain whether the person or entity under review has followed the rules, policies, procedures, laws and regulations with which they must conform.

Performance audits are concerned with the economy, efficiency and effectiveness of an organization's activities.

A comprehensive audit may encompass elements of a financial statement audit, a compliance audit and a performance audit.

Internal audits are conducted to provide assurance about various aspects of an organization's activities.

Corporate social reporting disclosures include environmental, employee and social reporting.

Bloomcode: Comprehension

Difficulty: Medium

Learning Objective: Differentiate between types of assurance services.

Section Reference: 1.3 Different assurance services

CPA Competency: Auditing and Assurance

AACSB: Analytic

62. Describe the three levels of assurance. Name the types of engagements they would come up in and the expression of opinions that would be provided by the assurance provider

Answer:

Level of Assurance	Type of Engagement	Expression of Opinion
Reasonable	Audit	Positive
Limited	Review	Negative
None	Agreed-Upon Procedures	None

Bloomcode: Application

Difficulty: Medium

Learning Objective: Explain the different levels of assurance.

Section Reference: 1.4 Different levels of assurance

CPA Competency: Auditing and Assurance

AACSB: Analytic

63. What does pervasive mean? When would an auditor use an audit report that was material and pervasive?

Answer: 'Pervasive' refers to misstatements that are not confined to individual accounts or elements of a financial statement, or, if confined, the misstatements impact an extensive portion of a financial statement or are disclosures that are vital to a user's understanding of the financial statements.

An auditor would use an audit report that identified material and pervasive misstatements either in a situation that the auditor was either able to identify (adverse) or not able to identify (disclaimer of opinion) through sufficient and appropriate audit procedures.

Bloomcode: Comprehension

Difficulty: Medium

Learning Objective: Outline different audit opinions.

Section Reference: 1.5 Difference audit opinions

CPA Competency: Auditing and Assurance

AACSB: Analytic

64. How is the expectation gap caused and how can the effects on the expectation gap be reduced?

Answer:

In particular, the gap is caused by unrealistic user expectations such as:

- the auditor is providing complete assurance
- the auditor is guaranteeing the future viability of the entity
- an unqualified (clean) audit opinion is an indicator of complete accuracy
- the auditor will definitely find any fraud
- the auditor has checked all transactions.

The expectation gap can be reduced by:

- auditors performing their duties appropriately, complying with auditing standards and meeting the minimum standards of performance that should be expected of all auditors;
- peer reviews of audits to ensure that auditing standards have been applied correctly;
- auditing standards being reviewed and updated on a regular basis to enhance the work being done by auditors;
- education of the public;
- enhanced reporting to explain what processes have been followed in arriving at an audit

(reasonable assurance) or a review (limited assurance) opinion (significant improvements have been introduced by standard setters improving assurance reporting); and

- assurance providers reporting accurately the level of assurance being provided (reasonable, limited or none).

Bloomcode: Application

Difficulty: Medium

Learning Objective: Describe the audit expectation gap.

Section Reference: 1.8 The audit expectation gap

CPA Competency: Auditing and Assurance

AACSB: Analytic

CASE QUESTION

65. Vince Deroy owns Val D'Or Vineyards, a successful winery in the Thousand Islands region. Annual sales are \$3,500,000 and he has a \$1,200,000 loan with a local bank.

Sales are split between wine sales (88%) and wine tasting and catering (12%).

Vince has excellent personal relationships with his suppliers and has been provided with special contractual terms which allow him delays of up to 120 days to make invoice payments. These arrangements run out this year and he will have 30 days to pay after being invoiced.

The bank has made the \$1,200,000 loan to Val D'Or Vineyards based on an understanding that the company will undergo audits of its financial statements.

Vince is an astute entrepreneur and has set up an advisory board which consists of his bank manager, another wine grower in the region, his old high school ethics instructor and track coach, himself, and his accountant.

The board has discussed certain issues including the following:

- The need for assurance service providers to audit his financial statements so that users can be provided with assurance that his statements are relevant and reliable.
- Non-audit services that would provide advice on special projects he may be considering in the future.
- A proper accounting firm to conduct an audit mandate.

Required:

- a) What is the objective of a financial statement audit and how does it relate to Val D'Or Vineyards?
- b) Vince Deroy's financial statements must be *relevant and reliable*. What do these two terms mean in the context of this case?
- c) What three characteristics should Val D'Or Vineyards' auditors possess when conducting an audit? Explain them briefly.
- d) What are non-audit services? Can you describe possible non-audit services that Val D'Or Vineyards might employ?

Answer:

- a) A financial statement audit provides reasonable assurance about whether the financial statements are prepared in all material respects in accordance with the financial reporting framework.

The Val D'Or Vineyards auditors will use the rules of Canadian GAAP (either IFRS or ASPE) to ensure that the main current users (shareholders, bank, tax authorities) and potential users (suppliers, future investors) are provided with audited statements that will provide them with assurance. The auditors will lend credibility to the information because they are independent.

- b) Relevant Information is relevant if it has an impact on the decisions made by users regarding the performance of the entity. For example, the bank would be interested in evaluating past decisions made by Val D'Or Vineyards management and predicting whether the entity will remain viable (that is, a going concern) into the future. This will give them confidence that the \$1,200,000 loan will be repaid. Users like the bank or key suppliers of

Val D'Or Vineyards can use current information to estimate the future ability of the entity to meet its obligations.

Reliable Information is reliable when it is free from material misstatements (errors or fraud). The information must be unbiased; it must not be presented in such a way as to influence the decision-making process of the user. The best way Val D'Or Vineyards can ensure others will perceive that its financial statements are without bias, is through an independent audit of the statements.

c) When undertaking an audit, the auditor should use professional scepticism, professional judgment, and due care.

Professional scepticism

Professional scepticism is an attitude adopted by the auditor when conducting the audit. It means that the auditor remains independent of the entity, its management, and its staff when completing the audit work. In a practical sense, it means that the auditor maintains a questioning mind and thoroughly investigates all evidence presented by the client. The auditor must seek independent evidence to corroborate information provided by the client and must be suspicious when evidence contradicts documents held by the client or enquiries made of client personnel (including management and those charged with governance).

Professional judgment

Professional judgment relates to the level of expertise, knowledge, and training that an auditor uses while conducting an audit. An auditor must utilize their judgment throughout the audit. For example, an auditor must determine the reliability of an information source and decide on the sufficiency and appropriateness of evidence gathered, the procedures to be used in testing, and an appropriate sample size.

Due care

Due care refers to being diligent while conducting an audit, applying technical and statute-backed standards, and documenting each stage in the audit process.

d) Non-assurance services include management consulting, mergers and acquisitions, insolvency, tax, and accounting services.

Accounting firms are not the only providers of non-assurance services. Val D'Or Vineyards could hire someone to review its plan to expand its vineyard operations, as an example. Other types of services: corporate social responsibility, employee safety, tax planning, insurance arrangements for key officers of the company, etc.

Bloomcode: Analysis

Difficulty: Medium

Learning Objective: Differentiate between types of assurance services.

Learning Objective: Differentiate between the roles of the preparer and the auditor, and discuss the different firms that provide assurance services.

Section Reference: 1.3 Differentiate assurance services

Section Reference: 1.6 Preparers and auditors

CPA Competency: Auditing and Assurance

AACSB: Analytic

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