

# Chapter 1

## The Auditing Profession

### Audit Challenge

#### 1-1 Assessing Privacy Practices

1. Data could be obtained from numerous sources: for example, unshredded documentation from garbage bins about prescriptions, or someone listening in on a wireless local area network or accessing a router/modem using default passwords that were not modified. Poor security practices, such as weak passwords, passwords written on paper and stored under keyboards, or out of date firewalls (enabling hackers to access the network systems) could also provide access to gaming systems or prescription data.
2. Auditors should know the requirements of Canada's privacy legislation, the nature of control systems for manual and automated information systems, have awareness of best practices for security and privacy. Someone on the audit team should also be able to assess technical matters such as the functioning of firewalls, routers, data communications, and other security software in use by the organization being audited.
3. Internal auditors (with the CIA) designation, and qualified accountants should be skilled in control systems. Team members on the audit should also have skills in information technology (perhaps with the CISA designation).

### Concept Check Questions

**C1-1** *List and explain the five key elements of the definition of auditing.*

The five key elements of the definition of auditing are: (1) information (in a verifiable form); (2) standards or criteria to evaluate the information (generally an acceptable financial reporting framework such as ASPE or IFRS for Canadian financial statements); (3) accumulation and evaluation of evidence (to verify the information); (4) competent, independent person (who can effectively evaluate the evidence, independent of those who prepared the information); (5) reporting (communication of the results).

**C1-2** *Explain the difference between accounting and auditing.*

Accounting is the recording, classifying, and summarizing of economic events, while auditing is concerned with evaluation of the recorded information.

**C1-3** *Describe the economic reasons for conducting an audit.*

An independent audit can reduce information risk, which can help to improve the decision-making process of trading partners, investors, and other stakeholders.

**C1-4** *Explain the causes of information risk and how users can reduce the risk.*

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

**C 1-5** *Explain the difference between an attest and direct report engagement.*

In an attest engagement, management (usually referred to as “the client”) presents the subject matter information in a report or statement and provides the auditor with a written assertion that the financial statements are in accordance with the criteria (for instance, the applicable accounting framework in the case of financial statements). In a direct report engagement, the client makes a public assertion or prepares a report, such as a set of financial statements or a tax return. In these types of engagements, the assertion is implied. The auditor directly measures or evaluates the underlying subject matter against the criteria and issues a report that includes the subject matter information and a conclusion as to whether the subject matter conforms to the applicable criteria. Internal audit engagement and auditor general reports are good examples of direct report engagements.

**C1-6** *Explain how and why the auditor makes information trustworthy and credible.*

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

**C1-7** *Describe and explain the differences and similarities between a financial statement, compliance, and operational audits.*

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

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

**C1-8** *Describe and explain the difference and similarities among the various types of auditors.*

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

**C1-9** *What are the requirements to be a public accountant?*

A public accountant in Canada is required to have a CPA designation along with a public accountant's licence.

**C1-10** *What organization issues standards for assurance engagements conducted by public accountants?*

The Auditing and Assurance Standards Board (AASB) issues standards after following due process of input from the key stakeholders. CPA Canada is responsible for issuing the *CPA Canada Handbook*.

**C1-11** *Which audit professionals could conduct the audit of a company that manufactures automobiles? Provide examples of the types of assurance or nonassurance engagements they could conduct for this company.*

It depends upon which information requires assurance. Public accountants could conduct a financial statement audit (assurance engagement), evaluate the quality of information systems security (operational audit; could also be done by internal audit); examine effectiveness of data privacy (compliance audit or operational audit; could be done by PA, internal auditor, or governmental auditor). Other examples are possible.

## **Review Questions**

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

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

**1-3** Auditor independence is fundamental to the conduct of the audit and the auditor's role in protecting the public interest. In the case of the financial statement audit, when independence is impaired, the credibility of the financial statements, the auditor, and the auditor's report becomes questionable. This famous quote from Chief Justice Warren Burger, of the US Supreme Court, highlights the auditors' responsibility:

The independent auditor assumes a public responsibility transcending any employment relationship with the client. The independent public accountant performing this special function owes ultimate allegiance to the company's creditors and stockholders, as well as to [the] investing public. This 'public watchdog' function demands that the accountant

maintain total independence from the client at all times and requires complete fidelity to the public trust.

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

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

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

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

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

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

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

- **Information risk.** This risk reflects the possibility that the information upon which the business risk decision was made was inaccurate. A likely cause of the information risk is the possibility of inaccurate financial statements.

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

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

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

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

**1-11** Some Potential Engagements Include:

|                    | <b>Financial Information</b>   | <b>Non Financial Information</b>   |
|--------------------|--|--|
| Internal Auditor   | Audit of credit card expenditures and accounts payable expenses to determine if well-supported and for legitimate business purpose | Business Continuity Audit to test if systems can continue in the event of unforeseen incidences            |
| Government Auditor | Costs associated with a capital project funded by government.  | A variety of value for money audits – such as a direct report on management and use of surgical facilities |
| Forensic Auditor   | Fraud investigation into misappropriation of funds at community clinics  | Attestation report on internal controls over payroll   |

*Table Continued*



|                   | <b>Financial Information</b>                         | <b>Non Financial Information</b>   |
|-------------------|--|--|
| Public Accountant | Financial statements and other financial information | <p>Attestation Report on Internal Control over Financial Reporting</p> <p>WebTrust or SysTrust report could be prepared for transactions made via the hospital's secure web site or with respect to the quality of information systems used to process prescription medication</p> <p>Compliance with Agreements</p> |

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

## 1-12

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

|               |                     |   |                         |
|---------------|---------------------|---|-------------------------|
| <b>Nature</b> | Highly standardized | Not standardized, very specific, often very subjective, but usually objective | Highly non-standardized |
|---------------|---------------------|---|-------------------------|

|                                       |   |              |            |
|---------------------------------------|---|--------------|------------|
| <b><u>Performed By:</u></b>           |   |              |            |
| <b>Public Accountant</b>              | Almost universally                                    | Occasionally | Frequently |
| <b>Government Auditors</b>            | Occasionally  | Frequently   | Frequently |
| <b>Canada Revenue Agency Auditors</b> | Never   | Universally  | Never      |
| <b>Internal Auditors</b>              | Never, although they might review them for management | Frequently   | Frequently |



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

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

Other examples are possible.

**1-14** Audit services could be: financial statement audit. Other attestation services could be reviews of the personal financial statements of individual lawyers for inclusion with their tax returns. Attestation services could include a report on sales revenue for submission to a landlord (to adjust lease payments), or a report that provides assurance on the quality of accounts receivable for a bank holding a loan with the firm. Other examples are possible. Non-assurance services could include preparation of tax returns for lawyers, consulting advice on merging firm with another law firm (if also the auditor of financial statements will need to ensure that no independence threats)

### Multiple Choice Questions

**1-15** a. (3)      b. (2)      c. (2)      d. (1)

**1-16** a. (4)      b. (2)

### Discussion Problems

**1-17**

- a. The following parts of the definition of auditing are related to the narrative:
  - (1) Virms is being asked to issue a report about qualitative and quantitative information relating to trucks. The trucks are therefore the quantifiable information with which the auditor is concerned.
  - (2) There are three criteria which must be evaluated and reported by Virms: Existence of the trucks on the night of June 30, physical condition of each truck, and fair market value of each truck.
  - (3) Susan Virms will *accumulate* and *evaluate* four basic types of *evidence*:
    - *Count the trucks* to determine their existence.
    - *Use registration documents* held by Charon for comparison to the serial number on each truck to determine ownership.
    - *Examine the trucks* to determine each truck's physical condition.
    - *Examine the current blue book* to determine the fair market value of each truck.

- (4) Susan Virms, public accountant, appears qualified as a *competent, independent person*. She is a public accountant, and she spends most of her time auditing used automobile and truck dealerships and has extensive specialized knowledge about used trucks that is consistent with the nature of the engagement.
- (5) The *report results* are to include:
- which of the 20 trucks are parked in Regional's parking lot the night of June 30
  - the condition of each truck, using established guidelines
  - the fair market value of each truck using the current blue book for trucks
- b. The only parts of the audit which will be difficult for Virms are:
- Evaluating the condition, using the guidelines of poor, good, and excellent. It is highly subjective to do so. If she uses a different criterion than the blue book, the fair market value will not be meaningful. Her experience will be essential in using this guideline.
  - Determining the fair market value, unless it is clearly defined in the blue book for each condition.

### 1-18

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

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

- c. Incentives and Pressures for Consumers' Union
- Economic – Costs to provide service may be too great, accept advertising from auto manufacturers in its magazine
  - Social – pressure from automotive companies to provide favorable reviews
  - Impact on performance responsibilities - May cause Consumers to “cut corners” or if accede to pressure then reporting quality will decrease (self-interest versus responsibility to the public)
- d. Incentives and pressures for financial statement auditor
- Economic – Client fees, maintain good cost recovery
  - Social – pressure from client or audit partners to adjust the reported opinion
  - Impact on performance responsibilities – Issue incorrect report.

- e. The concepts of information risk for the buyer of an automobile and for the user of financial statements are essentially the same. They are both concerned with the problem of unreliable information being provided. In the case of the auditor, the user is concerned about unreliable information being provided in the financial statements. The buyer of an automobile is likely to be concerned about the manufacturer or dealer providing unreliable information.
- f. The four causes of information risk are essentially the same for a buyer of an automobile and a user of financial statements:
  - (1) *Remoteness of information* It is difficult for a user to obtain much information about either an automobile manufacturer or the automobile itself without incurring considerable cost. The automobile buyer does have the advantage of possibly knowing other users who are satisfied or dissatisfied with a similar automobile.
  - (2) *Biases and motives of provider* There is a conflict between the automobile buyer and the manufacturer. The buyer wants to buy a high quality product at minimum cost whereas the seller wants to maximize the selling price and quantity sold.
  - (3) *Voluminous data* There is a large amount of available information about automobiles that users might like to have in order to evaluate an automobile. Either that information is not available or too costly to obtain.
  - (4) *Complex exchange transactions* The acquisition of an automobile is expensive and certainly a complex decision because of all the components that go into making a good automobile and choosing between a large number of alternatives.
- g. The three ways users of financial statements and buyers of automobiles reduce information risk are also similar:
  - i. *User verifies information himself or herself* That can be obtained by driving different automobiles, examining the specifications of the automobiles, talking to other users and doing research in various magazines.
  - ii. *User shares information risk with management* The manufacturer of a product has a responsibility to meet its warranties and to provide a reasonable product. The buyer of an automobile can return the automobile for correction of defects. In some cases a refund may be obtained.
  - iii. *Examine the information prepared by Consumer Reports* This is similar to an audit in the sense that independent information is provided by an independent party. The information provided by *Consumer Reports* is comparable to that provided by a CPA firm that audited financial statements.

## 1-19

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

reduction in interest due to lower information risk. The following is the calculation of total costs for each loan:

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

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

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

- d. Vial-tek may desire to have an audit because of the many other positive benefits that an audit provides. The audit will provide Vial-tek's management with assurance about annual financial information used for decision-making purposes. The audit may detect errors or fraud, and provide management with information about the effectiveness of controls. In addition, the audit may result in recommendations to management that will improve efficiency or effectiveness.
- e. The auditor must have a thorough understanding of the client and its environment, including the client's e-commerce technologies, industry, regulatory and operating environment, suppliers, customers, creditors, and business strategies and processes. This thorough analysis helps the auditor identify risks associated with the client's strategies that may affect whether the financial statements are fairly stated. This strategic knowledge of the client's business often helps the auditor identify ways to help the client improve business operations, thereby providing added value to the audit function.

## 1-20

- a. Financial statement audits reduce information risk, which lowers borrowing costs. An audit also provides assurances to management about information used for decision-making purposes, and may also provide recommendations to improve efficiency or effectiveness of operations.
- b. Hogan and Czarnecki likely provide tax services, accounting services, and management advisory services. They may also provide additional assurance services other than audits of financial statements.

- c. Student answers will vary. They may identify new types of information that require assurance, such as environmental or corporate responsibility reporting. Students may also identify opportunities for consulting or management advisory services, such as assistance with the adoption of International Financial Reporting Standards.

**1-21** The major advantages and disadvantages of a career as an CRA auditor, public accountant, internal auditor, or provincial auditor are:

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

- b. The two best choices for the senior interested in becoming a certified fraud examiner would be starting out as either a CPA or an internal auditor. A CPA gains experience with internal controls and has an understanding of incentives and opportunities to commit fraud. An internal auditor gains experience with internal controls and has an in-depth understanding of

operations and the many facets of a business. CRA auditors and provincial auditors would be in demand for fraud examinations relating specifically to tax fraud or fraud at governmental entities (as was highlighted in the opening vignette).

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

### Professional Judgment Problems and Cases

**1-22** The PA firm for the Internet company described in this problem could address these customer concerns by performing a WebTrust attestation engagement. The WebTrust assurance service was created by the profession to respond to the growing need for assurance resulting from the growth of business transacted over the Internet.

Relevant principles for each of the customer concerns noted in the problem are as follows:

- processing integrity for: Accuracy of product descriptions and adherence to stated return policies
- online privacy and security for: credit card and other personal information
- online privacy and security for: selling information to other companies
- availability for: system failure

#### 1-23

- a. The objectives and criteria would be organized around the nature of the services to be delivered. Possible objectives include:
- Availability/Effectiveness: Rooms or space are available for all homeless individuals who need shelter during the winter.
  - Efficiency: Rooms for the homeless are provided at a reasonable cost (reasonable is subjectively defined, see possible criteria below).

Criteria for these objectives could include:

*Availability:*

- There is a reduced number of emergency calls for homeless who are frozen on the streets.
- Community support agencies report being able to find spaces for all homeless individuals requesting lodging for the evening.
- Occupancy rates for homeless shelters are lower (as there would be more capacity).

*Efficiency:*

- Community support agencies are aware of the costs of the locations being used for shelter, and refer clients to those services that have a lower cost first.

- Overflow shelter is paid for at a rate comparable to the cost of regular shelters.
- Overflow shelter should be held on a contingency basis only, and paid for on an as-needed basis.

**b. Key Findings:**

- There was more than sufficient availability of shelter for the homeless, and that they were directed to these shelters on an as needed basis.
- However, the costs of shelter for the homeless were excessive for the last three years, as the Agency contracted for rooms on a fixed cost basis, and all of those rooms were not required, resulting in an excess cost for the City of \$850,000 over a period of three years.

**c. Recommendations:**

Recommendations can vary; one possibility is to recommend that the Social Service Agency book overflow space for the homeless on a contingency basis, paying only for space that is used.

- d.** This type of engagement would likely involve a direct report. There does not appear to be any type of statement prepared by management to which the auditor could attest. These type of engagements are normally direct reporting engagements that will include objectives, criteria, findings, and recommendations.

**1-24**

- a.** The operational efficiency of the sales department could be assessed by a qualified accountant (which could include a PA, internal auditor, or other qualified accountant), while the other departments could be assessed by qualified accountants together with a qualified researcher and manufacturing consultant. Skills present should be familiarity with best business practices in the industry and functional area under audit, as well as skills in information technology, research and development, and production development and management.
- b.** The auditors may have difficulty developing criteria to conduct the audit (unless there are standard best practices available for the industry), which will make the engagement more judgmental. They may also have difficulty writing the report, since such audits are unique, and the report will need to be custom-written for the engagement.

**1-25**

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

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

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

## 1-26

a.

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

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

Information from Chapter 4 would indicate that safeguards for independence are:

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



## RESEARCH ACTIVITIES

### RA 1-1: Public Accountant Requirements

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

In this example, we refer to the CPA Ontario website at

<http://www.cpaontario.ca/Students/CPACertification/PEP/1014page17397.pdf>.

and

<http://www.cpaontario.ca/Students/CPACertification/ExpReq/1082page17971.aspx>

- a. The educational requirements for the CPA certification program are:
  - Post-secondary degree (120 credit hours or 90 credit hours) with appropriate subject coverage. If the student's degree is less than 120 hours or does not have the appropriate subject coverage, the student may complete courses from the CPA Ontario Pre-Requisite Education Program (PREP). Students must have a minimum of 60% in all required course and an overall 65% average in those courses.
  - Completion of the CPA professional educational program (PEP). Students enrolled accredited university graduate programs may be exempt from some of the CPA PEP modules.
  - Common Final Exam (CFE). This is a three-day national exam that all CPA students must pass.
- b. Students may enroll in the CPA certification program without having work experience; however, in order to obtain their designation, they must complete certain work requirements. There are six competencies in which students need to develop proficiency in any three management and/or financial accounting competencies and must be have an in-depth proficiency in two competencies (depending upon their career aspirations). Students have two options regarding completion of work experience – employment at pre-approved training office or experience verification (which requires more documentation and certification by supervisor). Both routes require 30 months of progressive experience and students must have a mentor.
- c. Students who wish to obtain a public accountants license, must choose assurance and tax as their electives in the PEP program and must work in an approved training office (which will allow students to develop the required depth for assurance and taxation).

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

## **RA 1-2: Assurance Standards**

- a. The Auditing and Assurance Standards Board (AASB) sets generally accepted auditing standards (GAAS) for financial statement audits and some other types of assurance engagements performed by public accountants, as well as related services such as compilation engagements and engagements to perform agreed-upon auditing procedures.

Its key mandate is to issue and publish auditing and assurance pronouncements based upon due process. This means that the Board will review theory and practice and consult and debate with affected parties (users, preparers, regulators, and auditors). It also represents Canada in the international standards setting process and recommends auditing and assurance research in Canada.

- b. For this part of the assignment, Instructors may choose a recent pronouncement and assign it or leave it at the discretion of the students. The purpose of the exercise is to expose students to what is involved in the standard setting process. Instead of choosing a standard, instructors may ask students to review one of the decision summaries to see what was discussed and the outcomes.

Decision summaries may be accessed at: <http://www.frascanada.ca/auditing-and-assurance-standards-board/meetings/decision-summaries/index.aspx>