Solutions Manual

**to accompany**

Auditing: A Practical

Approach

**Third Canadian Edition**

**by**

**Robyn Moroney**

**Fiona Campbell**

**Jane Hamilton**

**Valerie Warren**

# CHAPTER 1

# Introduction and Overview of Audit and Assurance

Description: cid:image003.jpg@01CD4AF3.E17BD5B0

**John Wiley & Sons Canada, Ltd.**

**2018**

**Chapter 1**

**Introduction and Overview of Audit and Assurance**

SOLUTIONS TO REVIEW QUESTIONS

**REVIEW QUESTION 1.1**

According to the CPA Canada Handbook, “an engagement in which an assurance practitioner aims to obtain sufficient appropriate evidence in order to express a conclusion designed to enhance the degree of confidence of the intended users other than the responsible party about the outcome of the measurement or evaluation of an underlying subject matter against criteria” (CSAE 3000 C12).

In the financial reporting context ‘assurance’ relates to the audit or review of an entity’s financial statements.

An audit provides reasonable assurance about the fair presentation of the financial statements, while a review provides limited assurance. The audit contains a positive expression of opinion (e.g. ‘in our opinion the financial statements ***are*** in accordance with Canadian GAAP), while the review contains a negative expression of opinion (e.g., ‘we have ***not*** become aware of any matter that makes us believe that…the financial statements are ***not*** in accordance with Canadian GAAP).

The **assurance practitioner** is an auditor working in public practice providing assurance on financial statements of publicly listed companies, or other entities. Intended **users** are the people for whom the assurance provider prepares their report (e.g., the shareholders). The **responsible party** is the person or organization (e.g., a company) responsible for the preparation of the subject matter (e.g., the financial statements).

An assurer must have the knowledge and expertise to assess the truth and fairness of the information being presented by the preparers. Auditors of financial statements need to be trained accountants with detailed knowledge about the complex technical accounting and disclosure issues required to assess the choices made by the financial statement preparers. When undertaking an audit, the auditor should use professional scepticism, professional judgement and due care.

Auditors should be independent of the client. Independent auditors have no incentives to aid the entity in presenting their results in the best possible light. They are concerned with ensuring that the information contained in the financial statements is reliable and free from any significant (material) misstatements (error or fraud). A user needs to believe that the auditor is acting independently. This means that not only should auditors be independent (i.e., not have any undue personal or financial incentive to protect the client), auditors should avoid doing anything that would cause a reasonable person to doubt their independence.

**REVIEW QUESTION 1.2**

The users of the financial statements issued by a large listed public company include shareholders, customers, suppliers, employees, lenders, competitors, and government agencies. They need information which will help them evaluate the following:

* + Future financial performance of the company (including profitability, liquidity and solvency
  + Whether the company has overseas operations and the nature of their activities in those countries (to evaluate exposure to foreign exchange risk, risk to the company of a change in economic conditions in those countries, and whether it is apparently supporting countries with dictators)
  + Possible lack of compliance with various laws and regulations, whether the company (and its industry) need government support.
  + Investors are concerned with the value of their investment, employees with their job security, customers with whether the company is likely to remain in business long enough to honour warranties, suppliers with whether they will be paid, lenders with the risk to their loans, competitors with the health of their rivals, and government agencies will be interested in taxes, tariffs, industry support, and economic growth.

Users of a sporting team’s financial statements are likely to be interested in the following:

* + Condition and performance of the team (its solvency)
  + Whether it is investing in physical facilities, player payments, etc.
  + Whether the sporting team supports local businesses and community groups.

Although sports teams are often companies limited by guarantee and have members, the members are usually unable to trade their interest in the team. Therefore, users of a sporting team’s financial statements are not concerned about profitability for its own sake, but whether it helps the team pay its players and expand its facilities. Creditors and lenders will be interested in the likelihood that they will be repaid. Government will be interested with sporting and community concerns.

**REVIEW QUESTION 1.3**

Audits are intended to provide the users of the audit report with a positive expression of opinion regarding the financial statements. An audit is performed using a risk based approach in order to perform procedures to obtain sufficient and appropriate audit evidence to reduce the audit risk to an acceptably low level. However, an auditor cannot review 100% of the transactions of an organization, for that reason, while they can provide an opinion, they cannot provide absolute assurance. Other limitations include human error or even fraudulent activities from the auditor.

**REVIEW QUESTION 1.4**

A performance audit (value-for-money audit or operational audit) is an assessment of the economy, efficiency and effectiveness of an organization’s operations. It can be conducted internally (by internal audit) or externally (by an audit firm) and across the entire organization or for part of an organization.

Management may request a performance audit (operational audit) of its own company (or part thereof) in order to assess the economy, efficiency and effectiveness of the organization. Ideally, the audit would identify issues that need to be addressed in order to increase the performance of the division or company. For example, the audit could examine a logistics department. It would assess the cost of running the department, the number of deliveries per input (such as labour hours, vehicle hours, etc), and indicators of delivery on time to the correct address.

A performance audit could be conducted on a government department or agency as part of the process of accountability to the public. Stakeholders of government entities are usually seen to be more interested in economy, efficiency and effectiveness than in profit, or surplus. Performance auditing can expose poor practices, or even corruption, in an organization. Performance auditing can provide information on the implementation of government policies. Regular performance auditing of government entities can help build trust between the government and the citizens.

**REVIEW QUESTION 1.5**

Internal auditors are employees of the company, and therefore cannot be completely independent of the company. However, it is possible to increase the independence of the internal audit department through means such as funding, terms of reference, and lines of reporting.

A well-funded internal audit department can investigate more issues and spend more time on each investigation, potentially increasing the chance of discovering fraud and other problems. An internal audit department with a small budget is likely to have fewer staff and less qualified staff (because they will be lower paid), and will have to make compromises on the issues to be investigated.

An internal audit department with wide terms of reference has the freedom to pursue the issues which the audit staff believe are most important or create the most risk for the organization. A department with narrow terms of reference could be limited to investigating only certain matters, or must seek the approval of higher levels of management before commencing any investigation.

If the internal audit department reports to the CFO it is possible that the CFO will prevent some issues from reaching other members of the management team, or the board of directors. Often, the problems will be within the CFO’s department, creating a conflict of interest for the CFO when deciding whether to report the issue more widely. An internal audit department that reports directly to the audit committee is outside the normal lines of management and reporting. The audit committee is part of the board of directors. Therefore, reporting to the audit committee increases the chance that the highest level of the organization is aware of the problems and will approve the investigation. The audit committee also deals with the external auditor. If the internal auditor reports directly to the audit committee it can communicate the issues to the external auditor and ask them to consider them, where relevant, as part of the financial statement audit.

Not all companies have an audit committee. Where the audit committee does not exist, the internal auditor could report directly to the full board of directors.

**REVIEW QUESTION 1.6**

Reasonable assurance is provided when an auditor provides a positive opinion, after obtaining sufficient and appropriate audit evidence, that the subject matter is fairly presented. Audits can be performed on a variety of subject matter; however the most common is financial information in the form of financial statements. Reasonable assurance provides a high level of assurance on the reliability of the subject matter; however because of its inherent limitations, it cannot provide absolute assurance. Those limitations include the use of professional judgement used in order to bring the audit risk to an acceptably low level as well as the fact that an auditor cannot review 100% of the subject matter. The assurance is generally provided in the form of an opinion on an audit report. (See 1.5 Different Audit Opinions in your chapter for further details).

**REVIEW QUESTION 1.7**

As defined in CAS 706 (CAS 706 (5)):

Emphasis of Matter paragraph means a paragraph included in the auditor’s report that refers to a matter appropriately presented or disclosed in the financial statements that, in the auditor’s judgement, is of such importance that it is fundamental to users’ understanding of the financial statements.

An emphasis of matter paragraph draws the attention of the reader to an issue that the auditor believes has been adequately and accurately explained in a note to the financial statements. The purpose of the paragraph is to ensure that the reader pays appropriate attention to the issue when reading the financial statements. The audit report remains unmodified and the user of the financial statements can still rely on the information contained in the financial statements (CAS 706).

The usual circumstance which would warrant an Emphasis of Matter paragraph in the auditor’s report is the existence of a significant uncertainty, the resolution of which may materially affect the financial statements.

From CAS 706:

A1. Examples of circumstances where the auditor may consider it necessary to include an Emphasis of Matter paragraph are:

* + An uncertainty relating to the future outcome of litigation or regulatory action.
  + Early application (where permitted) of a new accounting standard (for example, a new Canadian generally accepted accounting principle) that has a pervasive effect on the financial statements in advance of its effective date.
  + A major catastrophe that has had, or continues to have, a significant effect on the entity’s financial position.

CAS 706 stresses that the inclusion of an Emphasis of Matter paragraph in the auditor’s report does not affect the auditor’s opinion. An emphasis of matter can be included in an unmodified auditor’s report or a qualified auditor’s report (see example in CAS 706).

**REVIEW QUESTION 1.8**

As there are many users relying on the opinion an audit report presents, an auditor has responsibilities when providing an opinion. The auditor’s responsibilities include professional scepticism, professional judgement, and due care.

Professional scepticism is demonstrated when an auditor keeps a questioning mind. For example an auditor should not only rely on management assertions as there could be bias present; therefore the auditor should obtain other corroborative evidence in order to conclude that management representations are reasonable.

An auditor has the responsibility to exercise professional judgement. They should refer to their expertise, knowledge and training. Past experiences as well as instinct should not be ignored. If they feel they lack the professional judgment required, an auditor should take appropriate action such as finding the appropriate expertise or not accepting the engagement.

Due care is exercised by an auditor by being diligent, applying technical and statute-backed standards and by thoroughly documenting the work performed.

**REVIEW QUESTION 1.9**

The audit expectation gap occurs when there is a difference between the expectations of assurance providers and financial statement users. The gap occurs when user beliefs do not align with what an auditor has actually done. 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 unmodified (clean) audit opinion is an indicator of complete accuracy
  + The auditor will definitely find any fraud
  + The auditor has checked all transactions.

The reality is that:

* + An auditor provides reasonable assurance
  + The audit does not guarantee the future viability of the entity
  + An unmodified opinion indicates that the auditor believes that there are no material (significant) misstatements (errors or fraud) in the financial statements
  + The auditor will assess the risk of fraud and conduct tests to try to uncover any fraud, but there is no guarantee that they will find fraud, should it have occurred
  + The auditor tests a sample of transactions.

The audit 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)
  + Assurance providers reporting accurately the level of assurance being provided (reasonable, limited, or none).

The audit expectation gap is represented graphically in Figure 1.7 of the text.

**REVIEW QUESTION 1.10**

The two main bodies that regulate auditors are Canadian Securities Administrators (CSA) and the Canadian Public Accountability Board (CPAB).

CPAB registers auditors for public companies, processes annual statements from registered auditors, enforces independence requirements and provides a whistleblowing facility for the reporting of contraventions of the appropriate Corporations Acts. CPAB conducts an audit inspection program to report on audit quality and make recommendations for continued improvement. CPAB visits a selection of firms annually to gain an understanding of their policies and procedures in relation to their independence, audit quality, methodologies and training programs.

The CPAB also responds to allegations that an auditor has breached the appropriate Corporations Act or the standards set out by the Accounting and Assurance Standards Board (AASB). The CPAB, and AASB will be involved when it is believed an auditor has not carried out their duties properly, is not a fit and proper person, is subject to disqualification or should not remain registered for some other reason. In response, they may cancel or suspend the individual’s registration, give the individual a warning or ask them to make an undertaking to improve their conduct.

The inspection process concentrates on an audit firm’s compliance with auditing standards, and their independence and quality control systems. The process includes

* + Reviewing and undertaking limited testing of the firm’s independence and quality control systems
  + Interviewing the leaders of the audit firm, human resources personnel and selected partners and staff
  + Examining the firm’s audit methodology for compliance with auditing standards
  + Reviewing the conduct of aspects of selected audit and review engagements.

The program finishes with an exit meeting and CPAB sends the audit firm a confidential report of their findings. CPAB publishes a public report summarizing all their findings.

CPAB - Practice Inspections

* + In accordance with CPAB's mission, they have developed a program of quality inspections which covers all firms who audit reporting issuers who issue securities to the public in Canada and are subject to the rules of provincial or territorial securities commissions.
  + Registered firms who audit reporting issuers are subject to inspection by CPAB. Their current practice inspection program selects firms for inspection on a cycle ranging from one to three years according to certain criteria. Annually, CPAB monitors the ongoing effectiveness of its practice inspection program and publishes a report highlighting inspection findings from the current year as well as trends relating to audit quality.
  + As part of their inspection process, CPAB has the right to take a disciplinary action against firms or individuals that CPAB has determined did not perform audits in accordance with professional standards.

(see http://www.cpab-ccrc.ca/ for further information)

SOLUTIONS TO PROFESSIONAL APPLICATION QUESTIONS

**PROFESSIONAL APPLICATION 1.1 – Assurance engagement**

An assurance engagement is defined as “an engagement in which an assurance practitioner aims to obtain sufficient appropriate evidence in order to express a conclusion designed to enhance the degree of confidence of the intended users other than the responsible party about the outcome of the measurement or evaluation of an underlying subject matter against criteria”

In the case of Bravo Bags, Brad Pope, CPA was engaged to issue a written conclusion. In order to express that conclusion, he must obtaining sufficient and appropriate evidence in order to determine whether the actual results indicated by Bravo Bags meets the lease agreement criteria. The results of the conclusion will enhance the landlord’s confidence that Bravo Bags has met the requirements of the lease. Therefore, the requirements of an assurance engagement are met as there is a practitioner (Brad Pope, CPA), who will issue a conclusion on the subject matter (the lease agreement) to a user (the landlord).

**PROFESSIONAL APPLICATION 1.2 – Demand for assurance**

The three theories discussed in the chapter are agency theory, the information hypothesis and the insurance hypothesis.  
Agency theory suggests there are incentives to hire an auditor to assess the fair presentation of the information contained in the financial statements. An auditor reports to the members on the fair presentation of the financial statements prepared by the manager. Good quality managers are willing to have an audit of their results because it allows them to distinguish themselves from poor quality managers. Shareholders are willing to pay the audit fee (i.e. the audit fee is paid by the company, reducing the profit available to distribute to the shareholders) to monitor the managers (who are their agents). Good quality auditors are more highly valued for this monitoring function than poor quality auditors. Andersen’s lowered their quality through their involvement with Enron, leading some companies to prefer another auditor. It has been suggested that companies taking early action to dismiss Enron could have protected their share price by retaining their financial reporting credibility. Ultimately, all Andersen’s clients had to find another auditor.

The information hypothesis suggests that financial statement users value higher quality information. Higher quality auditors are associated with higher quality financial statements. Therefore, when Andersen’s quality was called into question by their association with Enron, their client companies that valued higher quality auditors switched to another auditor.

Insurance hypothesis suggests that investors insure against their losses from company failure by purchasing an audit. When Andersen’s credibility was damaged by the Enron affair, there was doubt about their ability to survive and provide the insurance for such losses. The insurance factor is ‘impounded’ into share prices, so when the insurance cover is lost the share price should fall. This means that companies that were more sensitive to the loss of the insurance cover were more likely to dismiss Andersen early.

**PROFESSIONAL APPLICATION 1.3 – Assurance providers**

a) The solution will depend on the accounting firm chosen and the date of the analysis.

However, the answers should show for the Big 4: greater geographic coverage, larger numbers of staff and broader range of skills offered, greater claims to

specialization and industry coverage, more publications available (particularly from the international offices), more consistent and sophisticated marketing.

b) Financial statement audits are mandatory for most companies, so overall demand is largely fixed or determined by economic conditions affecting the number of companies. However, for organizations that are not required by legislation to have an audit, there are two opposing pressures in times of economic recession. First, cost-cutting would result in fewer audits. Second, organizations with less credible financial statements will face most difficulty in borrowing during a credit squeeze. This suggests that demand for auditing will increase in difficult times, because an audit will increase the credibility of the statements and thus increase access to external finance.

Also, shifting from a national auditor to a Big 4 auditor would increase both costs and financial reporting credibility for a company. Therefore, it can be argued that

firms with greater need to reduce costs will shift ‘down’ from Big 4 auditors to national auditors, but firms with greater need for credibility (and financial advice)

will shift ‘up’ from national auditors to Big 4 auditors.

**PROFESSIONAL APPLICATION 1.4 – Types of assurance engagements**

A review provides limited assurance. The auditor does adequate work to report whether or not anything came to their attention, which would lead them to conclude that the information being assured is not fairly presented.

To comment on the appropriateness of a review for financial statements, the differences between an audit and a review should be identified.

* + Assurance: reasonable vs limited
  + Opinion: positive vs negative
  + Procedures: nature, timing and extent – review procedures are a subset of those performed for an audit
  + Reports: annual reports – both audits and review engagements are appropriate for annual reporting as long as they achieve the desired level of assurance for the stakeholders.
  + Other factors Securimax Limited should consider when changing from an audit to a review engagement:
  + Cost: A review engagement is less costly than an audit
  + What are the bank requirements?
  + Are there any international requirements?
  + Are there any plans for an initial public offering?
  + They obtain large government contracts; are there any requirements from their clients to obtain an audit?
  + If an audit is required in the future, there can be increased costs to go from a review engagement to an audit engagement. There could also be the possibility of a qualified opinion (e.g. opening inventory balances)
  + Conclusion: Review engagement reporting is more limited than auditing and thus a lower level of assurance is appropriate as long as it is understood and agreed to by the stakeholders.

**PROFESSIONAL APPLICATION 1.5 – Expectations gap**

The expectations gap is the difference between the expectations of financial statement users and the auditor’s performance.

Special users for Securimax could include:

* Government agencies, including Department of Foreign Affairs and Trade, who would be interested in the purchases by foreign governments and individuals of this type of security vehicle.
* Competing companies and/or governments who would be interested in sensitive information about the construction of the vehicles and the identity of the purchasers.
* Waterloo local government and Ontario Provincial Government, who would be interested in the financial viability of the business and its impact on local employment and economic activity.
* Suppliers of technological equipment – it is possible that the Terrain Master uses specialized components. These suppliers would be interested in the financial viability of the business and the likelihood of its timely payment for goods purchased on credit. Such equipment could be made to specialized order with limited alternative customers. The suppliers would have large investments to support the manufacture of these specialized components.
* Other potential customers.
* Usual relationships would exist with lenders, shareholders, employees.

Discussion:

Consider how well would Securimax’s financial statements provide the information that these users would require, given the highly sensitive and confidential nature of the manufacturing process. Management is responsible for preparing the reports, but the users may look to the auditors to make sure that the required information is provided. Also consider how well would the audit process be able to meet the users’ needs for this information.

**PROFESSIONAL APPLICATION 1.6 – Performance and compliance audits**

TLCL must comply with the Department’s ‘Guidelines for Procurement of Medical Equipment’ when purchasing the accelerator. We are not provided with this document, but it is likely to contain rules about approved suppliers, the tendering/purchasing process (including the type of supplier/equipment documentation required), and so on. The auditor will gather evidence about TLCL’s purchases of the linear accelerators and assess whether the guidelines were followed. If the guidelines are specified with a great deal of detail, the audit will focus on ensuring that these guidelines were followed as specified. If the guidelines are expressed loosely (e.g., ‘the firm should obtain a number of quotes’), the auditor will need to use more judgement to assess compliance than if the guidelines are expressed precisely (e.g., ‘the firm will obtain 3 quotes’). The auditor will have to decide if the number of quotes obtained in those circumstances is sufficient to satisfy the loosely expressed guidelines. Are two quotes sufficient? If three quotes are required, the auditor could decide that two quotes are not sufficient, unless there are extenuating circumstances (e.g., there are only two possible suppliers worldwide).

**PROFESSIONAL APPLICATION 1.7 – Types of assurance engagements**

a) A review engagement is required because the bank requires a certain level of

assurance, but it has already been agreed that an external audit will not be re- quired. A review provides limited assurance. The auditor does adequate work to report whether or not anything came to their attention, which would lead them to conclude that the information being assured is not true and fair.

b)The title of the report or communication that Smith & Jones will prepare is an

”INDEPENDENT PRACTITIONER’S REVIEW ENGAGEMENT REPORT”

c) The types of procedures that Smith & Jones would be required to conduct in this

review engagement would be inquiry and analysis to address high risk areas where it was determined material misstatements could arise and to address all material items in the financial statements. Some of the procedures performed will be to compare year over year balances, considering the relationships between financial statement data, and calculation of various financial statement ratios. Once unusual or significant fluctuations are identified, the auditor then inquires and discusses with the client whether these fluctuations and changes are plausible.

**PROFESSIONAL APPLICATION 1.8 – Audit opinions**

a) Unmodified with Emphasis of Matter.

b) A disclaimer of opinion.

c) Either an adverse opinion or a qualified opinion.

d) Either a disclaimer of opinion or a qualified opinion.

e) A disclaimer of opinion.

f) A qualified opinion.

g) Either an adverse opinion or a qualified opinion.

**PROFESSIONAL APPLICATION 1.9 – Types of audit opinions**

**Situation 1**

a)Unmodified , qualified or disclaimer of opinion.

b) The client has, in effect, imposed a scope limitation on Aschari and Di Tomaso. The

type of report issued depends upon the materiality of accounts receivable and the

likelihood that a potential error would be material or significantly material.

If the account receivable balance were insignificant and immaterial, then an

unmodified report could still be issued. If the likelihood that a potential error would

be material, but not pervasive, then an opinion qualified as to scope would be

appropriate. If the likelihood that a potential error would be material and pervasive,

then a disclaimer of opinion would be warranted.

**Situation 2**

a) Unmodified or adverse opinion.

b) By not including the probable need to pay $3,000,000 as a result of the lawsuit in

the financial statements, they are likely materially misstated. If the financial

statements are considered to be materially misstated but not pervasive, a qualified

opinion would be appropriate. If the statements are considered to be both materially

and pervasively misstated, an adverse opinion would be appropriate.

**PROFESSIONAL APPLICATION 1.10 – Different audit opinions**

He should review the completed financial statements and the working papers to satisfy himself that:

* + The financial statements are not materially misstated;
  + They present fairly the financial position of the company; and
  + The information provided is in accordance with Canadian GAAP.

**PROFESSIONAL APPLICATION 1.11 – The audit expectation gap**

a) The auditor is responsible to provide an opinion on the fair presentation of the

historical financial statements in accordance with Canadian GAAP, unless they are engaged to provide assurance on other information. Therefore, auditors do not review press releases and other information that may be distributed to the users and other stakeholders. Auditors do have a responsibility to ensure offering documents provided by the company are consistent with the financial statements but they do not provide assurance over that information.

b) The audit expectation gap occurs when there is a difference between the

expectations of assurance providers and financial statement users.

In this case, the users seem to believe the auditor should have provided more

information with respect to the future success of the company. This demonstrates

the “expectation gap”, where users tend to blame the auditor when companies fail. Users tend to believe that the auditor should have done more (i.e., provided

assurance over the success of research expenditures). Auditors however, tend to

avoid opinions over such subjective information, therefore, research costs are

expensed, as to whether they will lead to a future benefit, is too difficult to verify.

c)The audit 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 (moderate or limited assurance) opinion (significant improvements have been introduced by standard setters improving assurance reporting),
* Assurance providers reporting accurately the level of assurance being provided (reasonable, limited, or none),

**PROFESSIONAL APPLICATION 1.12 – Audit reports**

a)The audit report highlight to readers that the management of the company and

the auditors have separate and distinct responsibilities. Management is

responsible for maintaining the accounting systems and internal controls,

assessing the ability to continue as a going concern, and preparing and ensuring

the fair presentation of the financial statements. The auditors are responsible for

conducting an audit of these reports by evaluating their contents against the

criteria of the accounting standards and relevant legislation. The auditor’s

responsibilities do not include preparing the reports and the auditor must use

judgement when choosing procedures and evaluating the evidence. It also

highlights that there is no guarantee that an audit performed in accordance with

standards will detect all material misstatements.

b)In an independent auditor's report, the paragraph is headed ‘Opinion’. It states

that in the independent auditor’s opinion the reports are consistent with the

relevant standards and legislation including a fair presentation of the financial

position and performance of the company. This means that the opinion is

unmodified.

c)In a review engagement report, the auditor expresses a conclusion, not an

opinion, in the review report. It is not an opinion because they did not conduct an

audit. The statement is a negative one – ‘nothing has come to our attention ...’.

d)Other differences include:

* The opinion is the first paragraph of the audit report. The conclusion is the last paragraph of the review engagement report.
* The audit report may include a Key Audit Matters section. There is nothing similar included in the review engagement report.
* The audit report contains expanded auditor responsibilities.
* A description of the work done by the auditor indicates that the procedures used for the review engagement are less comprehensive than those done for the audit. This is the main difference why the audit report contains an opinion and the review report expresses a conclusion rather than an opinion.

**PROFESSIONAL APPLICATION 1.13 – Being an auditor**

a)There is a gap between Kim’s expectations and the level of auditor performance. An audit provides reasonable assurance, not absolute assurance. The audit enhances the reliability and credibility of the information included in a financial

statement but is not a guarantee that the financial statements are free from error

or fraud, or that the company will not fail. Partly, this is because of the nature of

financial reporting. It requires judgements about accounting estimates and the

choice and application of various accounting methods. There is usually not one

‘right’ answer for a company’s profit. The auditor cannot guarantee the profit

reported by the company is ‘right’, only provide assurance about the

appropriateness of the accounting method selection and application and the

accounting estimates. Another reason the assurance is not absolute is the nature

of the audit process. Auditors cannot review every transaction and account

balance so use sampling (which could mean that representative items are not selected for testing), some transactions and balances are difficult to gather reliable evidence about, clients can conceal evidence, and auditors have a limited time frame in which to complete the audit.

b)Professional scepticism is required of an auditor. It is an attitude that requires the auditor to remain independent of the client and its staff. The auditor has a questioning mind and thoroughly investigates all evidence presented by their client. This does not mean that they regard the client as a liar, but that they need to do more than simply take the client’s word about anything. Usually, there will be confirming evidence which supports the client’s statements (e.g. copies of contracts, minutes of meetings, etc.). Evidence gathered from independent third parties is generally regarded as more reliable than that gathered from the client. Managers will not always try to deceive auditors, but auditors must take the responsibility of gathering evidence to verifying managers’ statements. The auditor needs to be alert to the fact that some managers will try to deceive auditors sometimes.

**Case Study — Cloud 9**

a)The objective of an audit is to obtain reasonable assurance by gathering sufficient evidence upon which to form a positive expression of an opinion regarding whether the information being assured is presented fairly. This means that the auditor has done adequate work to report with reasonable certainty that the information being assured is, or is not, reliable. This does not reflect absolute assurance, as an auditor can never be 100% certain that there are no errors or omissions. For example, an auditor is in the position to say whether in their opinion the financial statements are in accordance with relevant laws and accounting standards and they present fairly the financial position of the reporting entity. Auditors can only make such a positive statement if they are reasonably sure that the evidence gathered is sufficient. The audit of a company’s financial statements is one example of a reasonable assurance engagement. CAS 700 *Forming an Opinion and Reporting on Financial Statements* provides guidance on the form and elements of the audit report. The audit opinion will depend upon the auditor’s findings while conducting the audit. Reasonable assurance is the highest level of assurance provided; again, note that it is high but not absolute assurance.

The objective of a review engagement is to obtain limited assurance by gathering sufficient evidence upon which to conclude on the reliability of the information being assured. This means that the auditor has done adequate work to report whether or not anything came to their attention that would lead them to believe that the information being assured is not worthy of belief. The auditor is not in a position to say that in their opinion the financial statements are in accordance with the relevant law and accounting standards, and does present fairly the financial position and performance of the reporting entity. The auditor is only able to say that nothing makes them believe otherwise. To make a negative statement, auditors do not need to be as sure about the evidence as they must be to make a positive statement. The review of a company’s financial statements iscalled a review engagement. A review engagement may be requested when the client requires some assurance over the financial statements but does not require an audit level of assurance. *CPA Canada Handbook* sections CSRE 2400 provides guidance on review engagements of historical financial information and the form and elements of the review report. The review report highlights the responsibilities of the auditor to comply with Canadian generally accepted standards for review engagements and that the financial statements comply with Canadian GAAP or another appropriate financial reporting framework. An explanation of the procedures used in conducting the review is provided. The report states explicitly that an audit was not performed and therefore an audit opinion is not being expressed. Finally, the review report includes the conclusion of the auditor that they were not aware of any matter that made them believe that the financial statements were not in all material respects in accordance with GAAP.

**Case Study — Cloud 9 (Continued)**

In conducting a review, an auditor will obtain an understanding of the entity under review; identify potential material misstatements where effort should be concentrated; and conduct analytical procedures, enquiries of entity personnel, and other tasks if needed. to aid in the formulation of their opinion. The work done when conducting a review is less extensive than the work done when conducting an audit. Specifically, an auditor will make enquiries of key personnel and apply analytical procedures. That is why an auditor can provide only limited assurance after completing a review. It is also why this engagement is less time- consuming and therefore less costly.

For a compilation engagement, an auditor compiles a set of financial statements based on the information provided by the client, ensuring mathematical accuracy but does not perform any procedures to assure that the information is not materially misstated, and therefore no expression of assurance is provided. However, the auditor must ensure that they are not associated with information that may be false or misleading. To ensure that users are aware that no assurance is being provided, the auditor attaches what is called a Notice to Reader report to the financial statements. The Notice to Reader report explicitly states that no assurance is being provided. For a compilation engagement, Canadian GAAP is not required as the financial reporting framework (however, it is the required framework for audits and review engagements).

b) Reasonable assurance is the highest level of assurance. It means that the auditor has conducted audit procedures and gathered sufficient and appropriate evidence to provide an opinion on the fair presentation of the financial statements. The auditor states, in an unmodified opinion, that they believe that the statements do provide a fair presentation of the financial position and performance of the client. Limited assurance is a lower level of assurance. The auditor performs limited procedures and gathers less evidence. The auditor provides a conclusion. They state that they have found no evidence which makes them believe that the financial statements do not provide a true and fair view of the financial position and performance of the client. Reasonable assurance is provided in an audit, limited assurance is provided in a review engagement.

c)Chip would ask that Ron have the financial statements for McLellan’s shoes audited rather than reviewed because the audit provides a higher level of assurance that the financial statements give a fair presentation of the financial position and performance of the business. The risk that the audit opinion is inappropriate is lower than the risk that a review conclusion is inappropriate. Chip would feel more confident about the information being provided if it is audited rather than reviewed.

**Case Study — Cloud 9 (Continued)**

d)Ron would be purchasing a service from an audit firm. Therefore, Ron would consider the benefits being offered by each firm and the price being charged. Auditors generally charge based on the amount of work being done (which would be affected by the size of the business and its complexity) and the difficulty in performing the work. For example, if the auditor was unable to use their normal audit software because it was incompatible with the business’s systems, they might be forced to use more expensive techniques to conduct the audit. The audit firm would evaluate the type of business and the type of accounting records being kept before quoting their price. Ron should consider how well he is likely to be able to work with the auditors, how easy they are to contact and whether he believes they understand his requirements, and how much time they would require at his business. Many clients would like the audit to be conducted as quickly as possible so that it doesn’t interfere too much with their normal operations. Ron might also consider whether he is likely to be given useful advice by the auditors, although as he is trying to sell the business he is unlikely to seek advice on how to improve his systems. Some clients try to ‘purchase’ the right opinion. Auditor’s professional ethics prevent them from being involved in ‘opinion shopping’, which is the practice of clients going to a number of audit firms seeking the opinion which would be most favourable.

**Research Question 1.1 – Chong and Pflugrath**

a)The question asks for the student’s view. The student should propose a standard audit report format with justification for each section. The factors to be considered include: report length, location of the audit opinion, plain or technical language. If the student regards the current audit report as the most appropriate, justification should still be provided and the student should discuss how the report conveys realistic expectations of the auditor’s role and the level of assurance provided. The students should provide evidence of different possible audit report formats as part of their discussion.

b) The arguments supporting auditors’ current practices and the users’ alternative expectations should be researched and discussed. Are there any arguments to support the auditors’ position that could not be regarded as merely defending existing practices? Are there any arguments to support critics who suggest that auditors should be doing more? Recent changes to the law suggest that regulators are willing to reconsider the auditor’s role (e.g. banning certain non- audit services, requiring an independence declaration, requiring audit partner rotation). If auditors proactively adopt these types of changes, is it possible that more draconian regulatory changes could be avoided?

**Research Question 1.2 – Access the CPA Canada Handbook ...**

a) CAS 230 *Audit Documentation*.

b)Each CAS has a different number of sections, depending on the volume required to express the standard. However, it is important to note the general structure that is present in each CAS as they all have the following sections (if that particular section is relevant to that CAS):

* + Introduction
  + Scope
  + Effective date
  + Definitions
  + Requirements
  + Application and other explanatory material
  + Appendices
  + Basis for conclusions.

c)The name of CSAE 3000 "Attestation Engagements Other than Audits or

Reviews of Historical Financial Information".

d)The Canadian Standards on Review Engagements (CSRE) should be used as guidance in preparing a review engagement; notably CSRE 2400 which was issued March 31, 2016 for periods ending on or after Dec 14, 2017.

e) The wording for the Notice to Reader can be found in the *CPA Canada Handbook*, Section 9200 "Compilation Engagements", para. 26. The AASB is currently developing an exposure draft that may bring changes to these standards.

**LEGAL NOTICE**

Copyright © 2018 by John Wiley & Sons Canada, Ltd. or related companies. All rights reserved.

Description: cid:image003.jpg@01CD4AF3.E17BD5B0

The data contained in these files are protected by copyright. This manual is furnished under license and may be used only in accordance with the terms of such license.

The material provided herein may not be downloaded, reproduced, stored in a retrieval system, modified, made available on a network, used to create derivative works, or transmitted in any form or by any means, electronic, mechanical, photocopying, recording, scanning, or otherwise without the prior written permission of John Wiley & Sons Canada, Ltd.

MMXVII xii F1