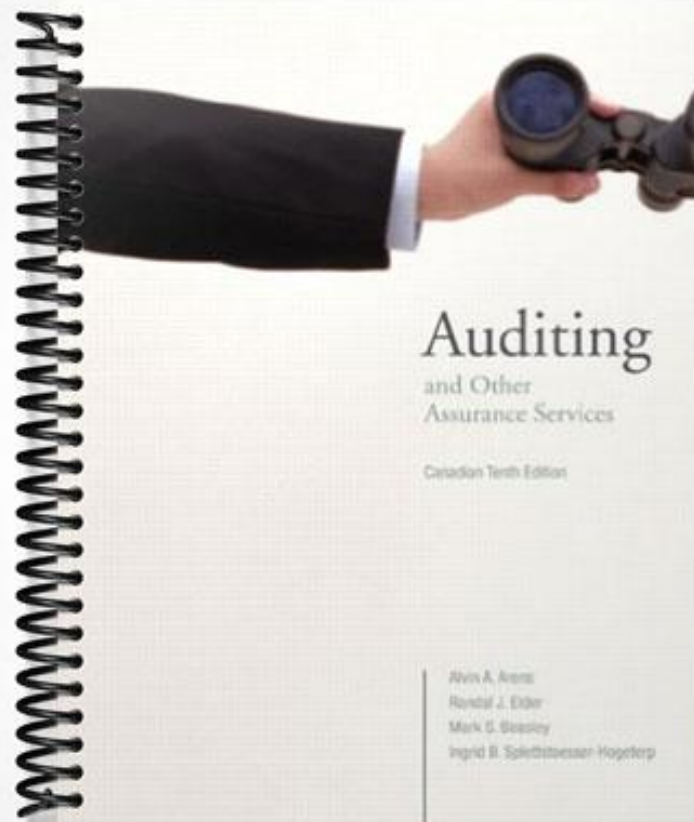


TEST BANK



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

- 1) Ethical behaviour is considered to be a cornerstone for trust in everyday life as well as in business practices. Ethics are 1) _____
- A) beliefs that we have about our own behaviour.
 - B) a set of moral principles or values.
 - C) laws that govern how businesses should behave.
 - D) rules in society that help us to do the right thing.
- 2) Ethical dilemmas occur when 2) _____
- A) you know what you want to do but the rules say otherwise.
 - B) a choice must be taken about appropriate behaviour.
 - C) a person chooses to act in his/her own interest.
 - D) businesses flout the laws and engage in illegal behaviour.
- 3) What is the likelihood of a public accountant facing an ethical dilemma during his or her business career? A PA would 3) _____
- A) have no ethical dilemmas as long as the rules of professional conduct are followed.
 - B) only have ethical dilemmas if he or she chose to act selfishly.
 - C) face few ethical dilemmas if high quality clients are selected.
 - D) face many ethical dilemmas.
- 4) Formal frameworks have been developed to help people resolve ethical dilemmas. After obtaining the relevant facts and identifying the ethical issues from the facts, what is the next step in the six-step ethical framework? 4) _____
- A) Identify the likely consequences of actions that will be taken
 - B) Determine who is affected by the outcome of the dilemma and how they are affected
 - C) Decide on the appropriate action to be taken in resolving the ethical dilemma
 - D) Identify the alternatives available to the person who must resolve the dilemma
- 5) When identifying who is affected by an ethical dilemma and how each is affected, it is important to realize that 5) _____
- A) both direct and indirect effects of the decision on you need to be considered.
 - B) typically more people are affected than you might expect.
 - C) you are the most important person in this situation, so consider your built-in ethics.
 - D) the rules of conduct require that you remain independent during your decision making process.
- 6) During the assessment of the consequences of each alternative choice of action for resolving an ethical dilemma, what best describes the type of effects that should be considered? 6) _____
- A) short term and long term
 - B) long term issues affecting your career
 - C) those immediately affecting the situation

D) direct and indirect

- 7) Society has attached a special meaning to the term professional. A professional is 7) _____
- A) someone who has both an education in the trade and on-the-job experience received under an experienced supervisor.
 - B) any person who receives pay for the services performed.
 - C) a person who is expected to conduct himself or herself at a higher level than the requirements of society's laws or regulations.
 - D) someone who has passed a qualifying exam to enter the job market.
- 8) The underlying reason for a code of professional conduct for any profession is 8) _____
- A) the need for public confidence in the quality of service of the profession.
 - B) that it provides a safeguard to keep unscrupulous people out.
 - C) that it allows licensing agencies to have a yardstick to measure deficient performance.
 - D) that it is required by federal legislation.
- 9) It is not practical for users to evaluate the quality of the performance of most professional services because of their 9) _____
- A) salaries and working conditions.
 - B) legal standing.
 - C) complexity.
 - D) veracity.
- 10) In a code of conduct, the advantage of general statements of ideal conduct, as opposed to specific rules of behaviour, is 10) _____
- A) the tendency to define the rules as maximum rather than minimum standards.
 - B) the emphasis on positive activities.
 - C) the enforceability of minimum behaviour and performance standards.
 - D) the ability to enforce the ideals.
- 11) The disadvantage of general statements in codes of professional conduct is 11) _____
- A) that they identify ideal conduct.
 - B) the emphasis on positive activities.
 - C) the difficulty of enforcing general ideals without minimum standards of behaviour.
 - D) that there are too many to remember.
- 12) Which of the following statements best describes why the profession of chartered accountants and other public accountants have deemed it essential to promulgate a code of ethics and to establish a mechanism for enforcing observance of the code? 12) _____
- A) A distinguishing mark of a profession is its acceptance of responsibility to the public.
 - B) A requirement of most provincial laws calls for the profession to

establish a code of ethics.

- C) An essential means of self-protection for the profession is the establishment of flexible ethical standards by the profession.
- D) A prerequisite to success is the establishment of an ethical code that stresses primarily the professional's responsibility to clients and colleagues.

- 13) One difference between auditors and other professionals is that most professionals _____ 13) _____
- A) don't have requirements for continuing education beyond university.
 - B) don't have to pass a rigorous examination.
 - C) aren't expected to act in the public interest.
 - D) need not be concerned about remaining unbiased.
- 14) The provincial institutes' *Rules of Professional Conduct* state, in part, that a public accountant should maintain integrity and due care. Integrity in the *Rules* refers to a public accountant's _____ 14) _____
- A) to be unyielding in all matters dealing with auditing procedures
 - B) reputation for honesty and fair dealing.
 - C) to distinguish independently between accounting practices that are acceptable and those that are not.
 - D) ability to maintain an impartial attitude on all matters that come under the public accountant's review.
- 15) Generally, all of the rules of professional conduct for CAs apply to _____ 15) _____
- A) students in public practice. B) members in public practice.
 - C) students and members. D) all members.
- 16) Which portions of the code of professional conduct are enforceable? _____ 16) _____
- A) the rules of conduct B) principles and rules
 - C) rules and interpretations D) interpretations
- 17) As a member of a professional accounting association, when considering the applicability of the rules of professional conduct, a PA would be responsible for compliance by _____ 17) _____
- A) themselves, their employees and partners.
 - B) their partners in the practice and themselves.
 - C) themselves only.
 - D) their employees.
- 18) According to the profession's ethical standards, an auditor would be considered independent in which of the following instances? _____ 18) _____
- A) The audit does not have enough employees to meet the client's reporting deadline.
 - B) The client comprises 75% of the auditor's fees.
 - C) The auditor's chequing account, which is fully insured by CDIC, is held at a client financial institution.
 - D) The client owes the auditor fees for two consecutive annual audits.
- 19) "Independence" in auditing means _____ 19) _____
- A) not being financially dependent on the client.

- B) being an advocate for the client.
- C) impartiality in performing professional services.
- D) remaining aloof from the client.

- 20) When public accountants are able to maintain an independent attitude in fulfilling their responsibility, it is referred to as independence 20) _____
- A) in fact.
 - B) in appearance.
 - C) in total.
 - D) in conduct.
- 21) When the users of financial statements have confidence in the independence of the public accountant, it is referred to as independence 21) _____
- A) in fact.
 - B) in total.
 - C) in appearance.
 - D) in conduct.
- 22) When should a PA assess the five threats to independence with respect to an audit engagement? 22) _____
- A) When deciding to accept a client or whether to continue an existing engagement
 - B) After a discussion with the Board of Directors
 - C) After signing the engagement letter and before commencing field work
 - D) After the completion of this year's audit, before starting the next engagement
- 23) Which of the following situations would be an example of a self-interest threat that would prevent PA from auditing the client? 23) _____
- A) PA's uncle owns the business that PA is auditing.
 - B) PA has purchased a used car from one of the employees of the client.
 - C) PA has a small bank loan at normal business interest rates with the bank that his firm is auditing.
 - D) For the last two years, the client could not pay their fees, so PA created a loan agreement covering the fees, with the client paying 10% interest on the fees.
- 24) Which of the following situations best describes a self-review threat? PA has completed the following work prior to commencing the audit engagement: 24) _____
- A) design and implementation of an inventory control system
 - B) personal and corporate tax returns
 - C) excise tax procedures evaluation
 - D) review of journal entries for recording depreciation expense
- 25) Why does a self-review threat pose a problem when conducting an audit engagement? 25) _____
- A) The audit is more expensive, as you have to provide clear documentation.
 - B) The auditor may not have the expertise to complete the special work.
 - C) The audit can be conducted more efficiently.
 - D) You are auditing your own work, and may not detect inadequacies.

- 26) Which of the following situations best describes an advocacy threat? PA 26) _____
has been hired to
- A) manage the accounting department for three weeks while the corporate controller is on vacation.
 - B) complete the personal tax returns of all executive management.
 - C) consult with the corporate controller and the bank manager about the conditions for financing a loan.
 - D) prepare the year end journal entries for a subsidiary company.
- 27) Which of the following situations best describes a familiarity threat? 27) _____
- A) PA has been working with this client for ten years, first as a manager, now as a partner
 - B) completion of corporate transactions for subsidiary companies
 - C) design and implementation of a new payroll system
 - D) preparation and entry of bookkeeping transactions
- 28) A familiarity threat at an audit engagement occurs when 28) _____
- A) the member discloses financial information about the client.
 - B) PA promotes the client's position to third parties.
 - C) the member has a financial interest in the client.
 - D) it is difficult to behave with professional skepticism.
- 29) Which of the following is the best example of an intimidation threat? 29) _____
Management
- A) has changed auditors of all of its subsidiary companies as they can get the audit done for a lower cost.
 - B) threatens to change auditors if you do not let them overstate accounts receivable by \$100,000 (the bad debt allowance is too low).
 - C) has decided to sue you because the audit fee was twice as high as they expected.
 - D) threatens to resign from the company if the board of directors does not give them a 15% raise.
- 30) An intimidation threat occurs when 30) _____
- A) the auditor has been working on a client engagement for many years and has trouble believing that management would deceive the auditors.
 - B) it is difficult to believe the actions of management because there is a suspicion of irregular activity with respect to the recording of transaction activity.
 - C) a client threatens the firm or its staff with respect to the content of the financial statements or with respect to the conduct of the audit.
 - D) the auditor suspects that fraud has occurred at the middle management level of the organization.
- 31) Some independence rules apply to all assurance engagements, while 31) _____
others apply only to a listed entity. For the purposes of assessing the independence rules, a listed entity is defined as
- A) an entity whose debt or shares is listed on a stock exchange, with market capitalization and total assets greater than \$10 million.

- B) any organization that has shares or debt listed on a stock exchange.
- C) an organization with share capital exceeding \$10 million that has public accountability.
- D) an organization that has shares or debt listed on a stock exchange, and that has redeemed shares.

32) Where an independence threat occurs, it is possible that only the person affected be removed from the engagement. In this case, other members of the firm can complete the engagement. An example of a situation where only the student or member would be excluded from the engagement is where PA 32) _____

- A) owns ten percent of the shares of the client.
- B) is a board member of the client with signing authority for cheques.
- C) used to be a controller at the client, but now works for the PA firm.
- D) has a significant financial interest in the client, such that influence could be exerted.

33) In addition to the appointment of the auditors, for listed clients, the audit committee must also approve 33) _____

- A) any services that are provided for senior management.
- B) the material that is included in the management letter by the PA firm.
- C) all services that the PA firm provides to the client.
- D) an engagement that might affect the appearance of independence, such as design of control systems.

34) At a small practice where the bulk of the work is accounting, bookkeeping, and review engagements, what is an important procedure that should be followed by the PA to help ensure independence? 34) _____

- A) All transactions should be prepared and processed by client personnel.
- B) Transactions and journal entries should be discussed with and approved by the client.
- C) The accountant should avoid doing bookkeeping for review engagements, and restrict this to compilation engagements only.
- D) Management should be trained in accounting principles so that they can adequately assess the PAs work.

35) When engagement staff at the PA firm have left the firm, and accepted a financial related position at the client within the last year, which type of engagement would be prohibited for the client? A(n) 35) _____

- A) audit of a listed entity
- B) non-assurance engagement
- C) review engagement
- D) audit of a non-listed entity

36) Which of the following professional requirements helps prevent opinion shopping from becoming an intimidation threat? 36) _____

- A) Management should inform the consulted accounting firm what the existing accounting firm's opinion is.
- B) The incumbent accounting firm needs to contact the consulting accounting firm with full information.
- C) Management needs to inform the incumbent accounting firm that they are going to change auditors.

D) The accounting firm consulted should communicate with the incumbent accountant.

- 37) The confidentiality requirements of the *Rules of Professional Conduct* apply to 37) _____
- A) audit and tax services, but not management consulting services.
 - B) audit and management consulting services, but not tax services.
 - C) only audit and review services.
 - D) all services provided by public accounting firms.
- 38) The confidential relationship will be violated if, without the client's permission, the public accountant provides working papers about a client to 38) _____
- A) the relevant provincial institute as part of a practice inspection.
 - B) another public accounting firm which has just purchased the public accountant's entire practice.
 - C) an investigative or disciplinary body of the relevant provincial institute which is conducting a review of the public accountant's practice.
 - D) a court of law which subpoenas them.
- 39) In which of the following circumstances would a public accountant be bound by ethics to refrain from disclosing any confidential information obtained during the course of a professional engagement? 39) _____
- A) The public accountant is issued a subpoena that orders the public accountant to present confidential information.
 - B) An inquiry by a disciplinary body of a provincial institute requests confidential client information.
 - C) Confidential client information is made available as part of a practice inspection of the public accountant's practice.
 - D) A major shareholder of a client company seeks accounting information from the public accountant after management declined to disclose the requested information.
- 40) The *Rules of Professional Conduct* state that a member in public practice shall not disclose any confidential client information without the specific consent of the client. This rule would be violated if a public accountant disclosed information without the client's consent as a result of 40) _____
- A) a subpoena.
 - B) a practice inspection.
 - C) a request by the client's largest shareholder.
 - D) a practice disciplinary hearing with the relevant provincial institute.
- 41) What should a PA do if approached by a client where he and his firm lack or do not have access to the technical knowledge required to complete the audit? 41) _____
- A) conduct the engagement, but prepare a qualified audit report
 - B) indicate that they can do a review engagement, not an audit
 - C) decline the new audit engagement
 - D) subcontract the audit to another firm

- 42) One of the general rules of professional conduct requires members to disassociate from information that is false and misleading. What is the purpose of this rule? To 42) _____
- A) improve the likelihood that due care will be followed in the conduct of the audit engagement
 - B) uphold the accounting profession's reputation for integrity
 - C) help ensure that only objective PAs are associated with the financial statements
 - D) ensure that auditors associate themselves with only fully accurate financial statements
- 43) How is GAAP enforced via legislation? 43) _____
- A) Financial executives may be sued if the financial statements prepared by their company are not in conformance with GAAP.
 - B) Tax authorities may sue corporations who do not prepare their financial statements in accordance with GAAP.
 - C) The Canada Business Corporations Act and many provincial incorporating acts require that financial statements be prepared in accordance with GAAP.
 - D) PAs who do not prepare financial statements in accordance with GAAP are expelled from their professional association.
- 44) Which one of the following forms of advertisement would violate solicitation rules? PA 44) _____
- A) placed a media advertisement listing the different types of expertise available at the firm's major office locations.
 - B) placed an advertisement in a newspaper indicating the opening of a new office.
 - C) conducted a survey asking companies about the types of services that are provided by their accounting firms.
 - D) conducted a cold-calling campaign where companies were asked if they would like to change PA firms.
- 45) Which one of the following situations is a violation of the professional rules of conduct? PA 45) _____
- A) resigned so that he could accept a position on the Board of Directors at a major client.
 - B) prepared personal and corporate tax returns for a client and all of its executive officers.
 - C) looked the other way when he noticed that one of his firm's accounting staff accepted money from client management.
 - D) placed an advertisement in the local paper indicating that she conducted audit engagements for five major insurance companies.
- 46) For which of the following engagements is a contingent fee permitted? 46) _____
- A) an audit engagement of a large listed corporation
 - B) an assurance engagement of leasehold payments for a rental agreement
 - C) a review engagement of a small manufacturing corporation
 - D) a tax consulting assignment assessing the excise tax payment processes

- 47) PA has been asked to accept the audit engagement of BarneyBlues Corporation. PA sent a letter to the predecessor auditor requesting whether there was any reason why he should not accept the engagement. Assuming that the prior year audit went smoothly, what would be an appropriate response by the predecessor auditor? 47) _____
- A) Provide a brief statement that there was no reason of which he or she was aware that would prevent accepting the engagement.
 - B) Send a copy of the tax returns and tax assessments to PA.
 - C) Telephone PA and say that PA should not take the engagement because the fee charged was too large.
 - D) Send a copy of the entire working paper file to PA.
- 48) The *Rules of Professional Conduct* require a successor auditor to communicate with the previous auditor. The primary concern in this communication is 48) _____
- A) to learn about client by examining predecessor's working papers.
 - B) to save successor auditor time and money in gathering data.
 - C) information which will help the successor auditor determine whether the client management has integrity.
 - D) to enable successor to perform a more efficient audit.
- 49) Many PAs prepare tax returns for individuals and for corporations. Under what circumstances is liability insurance required to cover the preparation of tax returns? When 49) _____
- A) fees are being charged and more than a handful of returns are being prepared
 - B) any number of tax returns are prepared, including no charge tax returns
 - C) the bulk of the PA's income comes from preparing tax returns
 - D) the PA is a member of a professional accounting association
- 50) PAs are members of a professional association that can impose sanctions for violations of the professional code of conduct. What is an example of a severe penalty that can be imposed by a professional association? 50) _____
- A) requirement to have another peer review conducted within one year
 - B) requirement of the completion of training courses
 - C) publication of information about the offense in a newsletter
 - D) expulsion from the professional association

ESSAY. Write your answer in the space provided or on a separate sheet of paper.

- 51) Describe an ethical dilemma that an auditor or an accountant might face in his or her business career, then illustrate how the auditor or accountant might use the six-step approach presented in Chapter 2 to resolve that dilemma. Be specific.
- 52) Discuss the ways the accounting profession and society encourage public accountants to conduct themselves in a professional manner; i.e., the factors that influence the ethical conduct of audit practitioners.
- 53) Identify and describe each of the three parts to the *Code of Professional Conduct*. Also discuss which parts are officially enforceable and which are not.

54) Each of the following situations involves a possible violation of the independence requirements provincial institutes' *Rules of Professional Conduct*. For each situation, (1) decide whether the *Rules* have been violated, and (2) briefly explain how the situation violates (or does not violate) the *Rules*.

A) Mike Lednický, public accountant, is a partner in the Oshawa office of Arthur & Thompson, public accountants. Mike's brother is employed as an inventory warehouse supervisor (an audit-sensitive position) by Sweeny Appliances, a publicly-held company in Manitoba. Sweeny Appliances is one of Arthur & Thompson's audit clients. Neither Mike nor the Oshawa office of Arthur & Thompson is involved in the audit of Sweeny Appliances.

Violation? Yes No
Explanation:

B) The accounting firm of Finke & Hersley, public accountants, provides bookkeeping and tax services for Hendershot Corporation. Finke & Hersley also performs the annual audit of Hendershot Corporation.

Violation? Yes No
Explanation:

C) Brent Shaw, public accountant, is the auditor of Cafe Eccel. A couple of weeks ago, Cafe Eccel's management expressed an intention to commence litigation against Brent, alleging he was negligent in last year's audit. Brent believes there is a strong possibility that management will proceed with the litigation. However, Cafe Eccel has not fired Brent as its auditor, and he is now working on the current year's audit of Cafe Eccel.

Violation? Yes No
Explanation:

D) Melissa Barry, public accountant, is the auditor of Audio Video Inc. Audio Video has not paid Melissa's audit fee for the past two years. Melissa is working on the current year's audit of Audio Video.

Violation? Yes No
Explanation:

55) Each of the following situations involves a possible violation of the provincial institutes' *Rules of Professional Conduct*. For each situation, (1) decide whether or not the *Rules* have been violated, and (2) briefly explain how the situation violates (or does not violate) the *Rules*.

A) Johnny Line has a successful dentistry practice in Calgary. Johnny has recommended one of his patients to Leslie King, public accountant. To show gratitude for the referral, Leslie has agreed to pay Johnny 5% of the fee for audit services rendered by Leslie to Johnny's patient. Leslie discloses the payment agreement to her new client.

Violation? Yes No
Explanation:

B) The \$40,000 if an adverse opinion is issued, and \$10,000 if a denial of opinion is issued.

accounting firm of Bayer & Peng, public accountants, is negotiating a fee with a new audit client.

Violation? Yes No
Explanation:

C) Don Smith, public accountant, takes part in the audit of Shaw Corporation. Don is not a partner or a manager in the public accounting firm, and does not own any stock in Shaw Corporation. Don's five year-old daughter, Betty Lou, received one share of Shaw Corporation's common stock for her fifth birthday. The stock was a gift from Betty Lou's grandmother. Betty Lou treasures that share of stock and is absolutely unwilling to part with it.

Violation? Yes No
Explanation:

They agree the client will pay \$75,000 if Bayer & Peng issues a clean,

D) Samantha Matthews, public accountant, is a partner in the Vancouver office of Dell & Bates, PAs. Samantha's brother is employed as the chief financial officer of Scotch Appliances, a large, publicly-held company in Toronto. Scotch Appliances is one of Dell & Bates' audit clients. Neither Samantha nor the Vancouver office of Dell & Bates is involved in the audit of Scotch Appliances.

Violation? Yes No
Explanation:

unqualified opinion, \$50,000 if a qualified opinion is issued,

E) On August 5, 2005, Page Dane, public accountant, issued the audit report on Borhut Corporation's June 30, 2005 financial statements. On August 30, 2005, Borhut paid Page's audit fee with stock rather than cash. Page sold the stock on September 15, 2005, two months prior to the beginning of the planning phase for the audit of the June 30, 2006, financial statements.

Violation? Yes No
Explanation:

- 56) Each of the following situations involves a possible violation of the provincial institutes' Rules of Professional Conduct. For each situation (1) decide whether or not the rules have been violated, and (2) briefly explain how the situation violates (or does not violate) the rules.

A) In 2002, Freidberg and Berlonski, both PAs, decided to form a PA practice. In 2006, Friedberg and Berlonski approached Anna Delaney, a physician and medical expert, and asked her to assist them with their growing medical consulting practice. Delaney agreed, but only after she was given an ownership interest in the firm. Delaney does not intend to quit her medical practice.

Violation? Yes No

Explanation:

B) On August 20, 2005, Barbie Anderson, PA and partner, was offered and accepted the engagement to audit the annual financial statements of Jungman Corporation for the fiscal and calendar years ended December 31, 2005. The interim audit began on September 15, 2005, and the year end audit ended on March 7, 2006. Jungman Corporation is listed on a provincial stock exchange. Barbie served as the controller of Jungman Corporation from November 5, 1999, until January 10, 2005, at which

time she
 terminat
 ed her
 employ
 ment
 with
 Jungman
 . Barbie
 owned a
 material
 amount
 of
 Jungman
 's
 common
 stock
 from
 Novemb
 er 5,
 1999,
 until
 August
 15, 2005,
 at which
 time she
 sold the
 stock.

Explanation:

C) Fenn and Nga, PAs, have extensive background in information systems and data processing. They have approached some of their audit clients about outsourcing their accounting processes to them. Two audit clients have decided to outsource their payroll and accounts payable processing to Fenn and Nga. This means that the accounting firm processes payroll transactions and accounts payable transactions, and prints reports and cheques that are returned to the clients for signature and distribution.

Violation? Yes No

Explanation:

D) Jimmy Chang decided that he wanted to attract more clients, so he advertised his sole proprietorship as Chang and Co., PAs in the local newspaper.

Violation? Yes No

Explanation:

E) Music While You Drive Ltd. (MWYDL) decided to switch auditors based upon an ad in a local newspaper. MWYDL is having cash flow problems and liked the idea of the fixed fee promised in the ad. The company was attracted by the audit firm statements that it performed superior work in auditing, tax and accounting, with 24 hour turnaround for personal tax returns.

Violation? Yes No

Viola
 tion?

Explanation: No

57) Raul, PA, received a call from his friend Cristobal Franco. He needed an audit urgently, because the bank might call his loan for his computer store CF Ltd. Since Cristobal had been his high school friend and they still played soccer together every two weeks, Raul agreed. Raul and Cristobal had a quick meeting, where Raul fixed the audit fee at \$10,000. Cristobal stressed the importance of an unqualified opinion for the bank.

Raul sent two available junior staff to CF's offices. The junior staff were experienced in review engagements, and had been working for Raul for about six months. The two staff had a quick look around the store, noting the documents strewn everywhere. The accounting staff came in and chatted briefly after their smoke break. They were about a month behind on recording transactions, because Cristobal had laid off one sales person. The accounting staff also helped out with providing sales quotes and Cristobal did all of the technical work.

At the end of the day, the junior staff were each given a \$250 gift certificate to be used in the computer store. This was great, because CF also sold MP3 players and supplies such as CDs and DVDs.

At dinner that night, the junior staff told their family that it would probably be a great idea to hold off on any computer supplies or equipment purchases that they needed, since CF would likely hold a sale in the next month or two to improve cash flow.

Required:

Identify and discuss the violations in the rules of conduct with respect to CF.

- 58) You are having lunch with a former employee of your firm, a friend of yours. Gino had been laid off last year when he had failed to pass his professional examinations for the third year in a row. Gino told you that he managed to obtain a CMA designation in the past year, and has started his public practice.

He has been circulating flyers and electronic email announcements with fixed rates: \$400 for a compilation engagement, \$1,000 for a review, and \$5,000 for an audit where revenues are less than \$1 million, \$15,000 for an audit for a client with revenues up to \$5 million. He already has clients to keep him busy for the next three months. He even has some feelers for clients that he personally handled while he was working for your firm — there were a lot of contacts developed during the five years that he was working there! To help attract some of the larger clients, he is considering not charging any fee for the first ten hours spent on tax-related services.

Gino ended the conversation by asking you if you would like to join him in his new firm, because at this rate he'll need a second person real soon!

Required:

Identify the violations in the professional rules of conduct and explain why they are violations.

- 59) You are the senior in charge of the accounts receivable section of the audit of a large clothing manufacturer downtown in the clothing district. The client sells to local clothing stores as well as to other retailers in the province.

Accounts receivables seem to be deteriorating, with many more accounts in the over 90 days column than in the past. You sent out twenty accounts receivable confirmations, but only six were returned. Of these six, only three confirmed the balance as in agreement with the client, while the others indicated that they kept their records on an open item basis (rather than a balance forward basis) and were unable to respond to the confirmation request. When you looked at the prior year's file, it seemed that the same thing had happened last year.

When you phoned the supervisor in charge of the audit engagement, she told you to not bother with follow up, as the engagement was already over budget and costs need to be kept down. You were concerned that you would be unable to state a conclusion with respect to the fairness of the accounts receivable balance and she was really angry with you, saying that she would have to sign off for you then.

Required:

Discuss the ethical and quality issues raised by this audit engagement.

- 60) Describe four activities undertaken by audit committees.

- 1) B
- 2) B
- 3) D
- 4) B
- 5) B
- 6) A
- 7) C
- 8) A
- 9) C
- 10) B
- 11) C
- 12) A
- 13) D
- 14) B
- 15) B
- 16) A
- 17) A
- 18) C
- 19) C
- 20) A
- 21) C
- 22) A
- 23) D
- 24) A
- 25) D
- 26) C
- 27) A
- 28) D
- 29) B
- 30) C
- 31) A
- 32) C
- 33) C
- 34) B
- 35) A
- 36) D
- 37) D
- 38) B
- 39) D
- 40) C
- 41) C
- 42) A
- 43) C
- 44) D
- 45) C
- 46) D
- 47) A
- 48) C
- 49) A
- 50) D

51) Although students' answers will vary depending on the dilemma, their answer should list

the of how each step relates to their particular dilemma:

1. *Obtain the relevant facts.* Students should list the key facts from their dilemma.
2. *Identify the ethical issues from the facts.* Students should identify the key ethical issue(s) in their dilemma.
3. *Determine who is affected by the outcome of the dilemma and how each person or group is affected.* Students should identify who is involved and how each party is affected by the dilemma.
4. *Identify the alternatives available to the person who must resolve the dilemma.* Students should list the alternatives available to the auditor or accountant.
5. *Identify the likely consequence of each alternative.* Students should identify both the short- and long-term effects of each alternative.
6. *Decide on the appropriate action.*

52) There are many factors that encourage public accountants to conduct themselves at a high level, including:

- GAAS and interpretations.
- *Rules of Professional Conduct.*
- Legal liability.
- Public accounting firm quality control standards.
- Practice inspection.
- Canadian Public Accountability Board
- Continuing professional education requirements.
- Professional examinations such as the CICA Uniform Final Examination.
- Provincial securities commissions.
- Audit committees.

53) The three parts to the *Code* are:

- *Principles.* These establish ideal standards of ethical conduct stated in philosophical terms. They are not officially enforceable.
- *Rules of conduct.* These are the minimum standards of ethical conduct stated as specific rules. They are officially enforceable.
- *Interpretations.* Interpretations of rules are intended to clarify the rules of conduct. They are not officially enforceable, but a practitioner must justify any departure.

54) A) No violation. Although partners in a public accounting firm are not allowed to have close relatives employed in a position of significant influence by a client, it is acceptable to have a close relative employed in an audit-sensitive position (with no significant influence), particularly as Mike is not involved in the audit engagement.

B) No violation. The *Rules of Professional Conduct* do not prohibit public accounting firms from providing bookkeeping, tax, and audit services to the same client, as long as the client is not a listed entity and management approves the journal entries.

C) Violation. When there is a lawsuit or intent to start a lawsuit between a public accountant and an audit client's management, independence is impaired.

D) No violation. While independence may be impaired if fees remain unpaid for services provided more than one year prior to the date of the report in some cases, there is no requirement under the *Rules of Professional Conduct* not to continue in the role as auditor. Melissa should document in her audit file how she has dealt with this self-interest threat and the steps that the client is taking to pay fees.

See the ICAO Rules of Professional Conduct at www.icao.on.ca

55) A) Violation. A public accountant may not pay a referral fee to a non-public accountant.

B) Violation. This is a contingent fee agreement which is prohibited by the Rules of

Professional Violation. Participants in an audit are prohibited from having a financial interest in the client. The rule also applies to the participant's dependents.

Conduct D) Violation. A partner's independence is impaired when he or she has a close relative employed by a client in a position of significant influence such as chief financial officer.

C) E) Violation. Public accountants are prohibited from owning stock in a client.

56) A) Violation. Delaney is not actively involved in the PA practice.

B) Violation. Since Barbie had an employment relationship with the client during part of the period covered by the financial statements (and owned stock during that period), her independence is impaired.

C) No violation. As long as the client is an unlisted entity and all of the transactions are approved and initiated by the client company, there is no violation. In addition, the client company would need to have controls in place to verify the accuracy and completeness of processed transactions, and personnel not involved with the audit should be the ones completing the outsourced transactions.

D) Violation. A sole practitioner must practice under his own name, and cannot give the impression that there is more than one PA in the practice.

E) Violation. PAs may not advertise superiority to other PAs. Also, fees charged should be commensurate with work performed to satisfy professional standards — normally this cannot be accomplished with a fixed fee.

See the ICAO Rules of Professional Conduct at www.icao.on.ca

57) Raul is too familiar (familiarity threat) with Cristobal (i.e. they are close friends socially, and have known each other for many years). This violates independence.

Raul set a fixed price for the audit without even assessing the amount of work to be conducted. This is a self-interest threat (the appropriate amount of work may not be completed as it will cost Raul money to do so), and jeopardizes the ability of the work to be properly completed in accordance with GAAS.

Cristobal indicated that he needed a clean audit opinion, and Raul complied. This could be as a consequence of the familiarity threat, but means that Raul could be associating himself with false and misleading financial information.

The junior staff are not competent to conduct an audit, so technical competence (GAAS) has been violated. They were also not properly supervised (a violation of GAAS).

Junior staff were bribed (the gift certificate) and should not have accepted the certificates.

The junior staff violated confidentiality when they discussed the likelihood of a sale at CF with their families.

See the ICAO Rules of Professional Conduct at www.icao.on.ca

58) Gino is actively soliciting clients of other firms (including his former employer) which is a violation. He should be placing general advertisements or providing only announcements.

Gino is providing fixed fee engagements, without conducting any planning or assessing the risk in the engagements. This means that he may be likely to conduct inadequate field work, violating GAAS.

the tax work is also a violation, since this creates the same type of pressure for Gino to not conduct his work in accordance with GAAS.

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See the ICAO Rules of Professional Conduct at www.ICAOn.ca

- 59) The engagement indicates a lack of planning, as you were only aware of the problems with the accounts receivable confirmation process after you had received the replies. The likelihood of non-response should have been considered before selecting and sending the confirmations.

The pressures by the supervisor to sign off on the audit engagement without completing the necessary audit procedures indicate a poor human resources environment at your audit firm. It also means that this audit (and other audits) may have inadequate evidence on file to support an opinion on the financial statements. This violates the general principle of due care and the third examination standard of sufficient appropriate audit evidence under GAAS.

- 60) Activities undertaken by audit committees include:

- reviewing the entire audit report,
- reviewing the scope and cost of the audit with the external auditors,
- acting as a liaison between the external auditors and management,
- adjudicating disputes between the external auditors and management,
- acting as a liaison between the internal auditors and management.
- adjudicating disputes between the internal auditors and management.