1. The auditor for Table Catering is examining the financial statements and notices an increase in the year-end ratio of bad debt expense to accounts receivable.

This may indicate which one of the following scenarios?

a) More sales occurred toward the end of the year.

b) Bad debts occur randomly and cannot be predicted.

c) Credit controls may have been loosened.

d) Accounts receivable are over-recorded.

The correct answer is (c) Credit controls may have been loosened.

Explanation (Assurance Perspective)

An **increase in the ratio of bad debt expense to accounts receivable** means:

$$\frac{\text{Bad Debt Expense}}{\text{Accounts Receivable}} \uparrow$$

This suggests that a higher proportion of receivables is expected to be uncollectible.

From an audit risk perspective, this often indicates:

- The company may be extending credit to riskier customers.
- Credit approval policies may have become less strict.
- Collection processes may have weakened.

All of these point to **loosened credit controls**.

2. The auditor for Callihan Software Co. is assessing the audit evidence gathered over the inventory cycle to ensure sufficient appropriate evidence has been obtained over the related accounts.

Which one of the following is the MOST reliable type of audit evidence over the inventory cycle?

a) Confirmation of bank balances for accounts from which supplier payments were made

b) Inspecting supplier invoices and bank statements showing payment

c) Footing (recalculating) the inventory subledger

d) Performing test counts of inventory

The correct answer is (d) Performing test counts of inventory

Why this is the MOST reliable evidence

Audit evidence is more reliable when it is:

- Obtained directly by the auditor
- Based on physical observation
- Not dependent on internal documents alone

When auditors perform **test counts of inventory**, they:

- Obtain **direct physical evidence**
- Address key assertions (especially **existence** and **completeness**)
- Reduce detection risk significantly

Under **International Auditing and Assurance Standards Board guidance (ISA 501 – Audit Evidence—Specific Considerations for Selected Items), physical observation of inventory counts is required when inventory is material.

Physical evidence is generally more reliable than documentary or analytical evidence.

3. Herman is inquiring with management of Illusion Pharmaceuticals (IP) about changes that have occurred in the year as part of the audit planning process. The CFO tells Herman that IP changed its depreciation accounting policy at the beginning of the year from the declining balance method to the straight-line method.

Which one of the following assertions is the main risk related to depreciation expense as a result of the change in accounting policy?

a) Accuracy b) Occurrence c) Completeness d) Existence

The correct answer is (a) Accuracy

Why Accuracy is the main risk

When a company changes its **depreciation method** (from declining balance to straight-line), the key risk is that:

- The new calculation may be incorrect
- The transition adjustment may be misstated
- Useful lives or residual values may not be applied correctly

- Comparative figures may not be properly adjusted (if required)

All of these relate directly to whether depreciation expense is **mathematically and technically correct** — which is the **accuracy assertion**.

Under accounting standards such as:

- International Accounting Standards Board (IFRS)
- Accounting Standards Board (ASPE Canada)

a change in depreciation method is treated as a **change in accounting estimate**, applied prospectively. This increases estimation and calculation risk — not existence or completeness risk.

4. Time Watch Co. (Time) manufactures watches that are sold on credit to retail customers across Canada.

Which one of the following is the BEST control that could be implemented to decrease the accuracy, valuation, and allocation risk in the accounts receivable (AR) balance?

a) A credit check is completed on each new customer before the first sale is made.

b) Sale prices on invoices are automatically applied from an approved price list.

c) Invoices are pre-numbered and sequence-checked for each sale.

d) Each month, an exception report that shows orders made but not yet shipped is created and reviewed.

The correct answer is (a)

Why (Audit Assertion Perspective)

The question focuses specifically on reducing risk in the **accuracy, valuation, and allocation** assertion for **Accounts Receivable (AR)**.

For AR, valuation risk primarily relates to:

- Collectability
- Adequacy of the allowance for doubtful accounts
- Overstatement of receivables

If the company performs a **credit check before granting credit**, it:

- Reduces the likelihood of uncollectible accounts
- Improves the quality of receivables

- Decreases bad debt expense volatility
- Reduces risk of overstatement of AR

That directly lowers **valuation risk**.

5. On December 31, Thomas spent the day attending the inventory count of his audit client, Tack's Wood Furniture. When the count was completed, Thomas received a copy of the count sheets and final inventory listing. He randomly selected a sample of 15 inventory items from the warehouse and counted each item, and then compared his count to the number of items on the count sheets and the final inventory listing. When performing this procedure, Thomas found that four of the 15 sample items from the warehouse were not included in the count sheets or inventory listing.

Which one of the following is the MOST likely implication of the issue discovered by Thomas at the inventory count?

a) The inventory balance does not exist.
b) The inventory balance is not valued accurately.
c) The inventory balance is not complete.
d) The inventory balance is not classified appropriately.

The correct answer is (c) The inventory balance is not complete.

Why?

Thomas performed the following procedure:

- Selected items **from the warehouse floor**
- Counted them physically
- Traced them to the **count sheets and final inventory listing**

This is called **floor-to-sheet testing**.

Floor-to-sheet testing primarily addresses the **completeness assertion**.

Since **4 of 15 items physically present were NOT included on the count sheets or final listing**, this indicates:

Items that exist are not recorded → inventory is understated → completeness issue.

6. Roberta, the auditor for Robin Airlines, is performing procedures over expenses. When selecting a sample of expenses, Roberta noticed that many expenses seemed to be rounded to the nearest thousand dollars. Roberta showed this to the audit manager, and they both agreed it was odd to see so many rounded journal entries. As part of the audit response, the audit manager asked Roberta to perform an additional audit procedure using audit data analytics.

In which one of the following ways could audit data analytics be used to investigate this issue?

a) Examine the population of journal entries for all entries rounded to the nearest thousand dollars.

b) Recalculate all expense totals by developing an expectation of each expense and comparing it to the amounts recorded.

c) Reconcile the population of all journal entries to the financial statements.

d) Perform a test of controls to determine whether expense invoices and transactions were approved before posting.

The correct answer is (a)

Why?

Audit data analytics (ADA) is especially powerful when analyzing entire populations to identify unusual patterns or anomalies.

In this case, the risk indicator is:

A large number of expenses rounded to the nearest $1,000

That pattern could suggest:

- Manual journal entries
- Management override
- Fraudulent adjustments
- Smoothing or manipulation of earnings

Using ADA, Roberta can:

- Filter or query the entire journal entry population
- Identify all entries ending in “000”

Determine frequency, timing, preparer, approver, and account type

Look for clustering near period-end

This directly targets the unusual pattern.

7. Xavier is performing audit procedures over the payroll cycle at Highlights Clothing Corp. (HCC). Xavier recalculates the expected payroll liability at year end based on the average payroll expense per pay period and the number of days in the final pay period from the year under audit.

Which one of the following statements BEST describes how the procedure performed by Xavier addresses the risks identified in the payroll cycle?

a) This procedure supports the cutoff of the payroll liability at year end.

b) This procedure supports the occurrence of payroll expense for the year.

c) This procedure supports the completeness of the payroll liability at year end.

d) This procedure supports the classification of the payroll liability at year end.

The correct answer is (c)

Why?

Xavier is:

Recalculating the expected payroll liability

Using average payroll per pay period

Applying it to the number of unpaid days at year end

This is essentially an accrual estimate for wages earned but not yet paid.

The key risk in payroll accruals at year end is:

Are all earned wages up to year end recorded?

If some days worked before year end are unpaid and not accrued, liabilities would be understated.

By independently estimating what the payroll liability should be, Xavier is testing whether:

The recorded payroll liability is complete
All earned wages have been included
That directly addresses completeness.

8. Verde Inc. is being audited for its June 30 year end. Sally is the junior auditor on the audit team, and she has been asked to perform audit procedures over the purchases, payables, and payments cycle. For one procedure, Sally examines the accounts payable (AP) listing and records the five vendors with the highest balances owed. When Sally compares the results of this procedure to that of the prior year, she notes that the three vendors with highest balances owed in the prior year were not included in the AP listing this year at all.

Which one of the following tables shows the risk of material misstatement tested as a result of this audit procedure?

a)

	Expenses	Accounts payable
Existence		X
Occurrence	X	
Completeness		
Accuracy		

b)

Existence		X
Occurrence		
Completeness	X	X
Accuracy	X	

c)

Existence		
Occurrence		
Completeness	X	X
Accuracy		

d)

Existence		X
Occurrence	X	
Completeness	X	X
Accuracy	X	

The correct answer is (c)

What procedure did Sally perform?

She:

Selected the largest vendors from the AP listing.

Compared them to prior year.

Noted that last year's top 3 vendors are missing entirely this year.

This is essentially a search for unrecorded liabilities / analytical review over major suppliers.

What risk does this address?

If major prior-year vendors:

Are not on the AP listing this year,

There is a risk that payables related to those vendors were not recorded.

That directly tests:

Completeness of accounts payable

Because AP is usually understated (liabilities omitted).

9. Kima Inc. had credit sales of $600,000 and cash collections of $450,000 last year. The ending balance in accounts receivable was $175,000. The allowance for doubtful accounts (AFDA) has a current credit balance of $2,600. Based on an aging analysis, Kima has estimated that the AFDA is 4% of the gross amount of outstanding receivables.

How much is the bad debt expense for the year?

Solution:

Step 1: Determine the required ending AFDA balance

Ending Accounts Receivable = $175,000

Estimated AFDA = 4% of gross receivables

= 175,000 × 4%

= 7,000

Required ending AFDA = $7,000 (credit balance)
Step 2: Determine current AFDA balance
Current AFDA balance = $2,600 credit
Step 3: Calculate bad debt expense
To increase AFDA from $2,600 to $7,000, we need:
= 7,000−2,600
= 4,400
So the adjusting entry is:
Dr Bad Debt Expense 4,400
Cr Allowance for Doubtful Accounts 4,400

10. LMN Inc. manufactures environmental testing equipment and reports under ASPE. The following is information for Years 3 and 4:

	Year 3	Year 4
Sales	$2,500,000	$2,600,000
Gross profit	1,000,000	1,200,000
Net income	125,000	150,000
Beginning inventory	275,000	300,000
Ending inventory	300,000	245,000

The industry average for inventory turnover is 5.00 times.
Which one of the following statements about LMN's inventory turnover ratio is true?
a) LMN's inventory turnover has worsened, and it is also worse than industry.
b) LMN's inventory turnover has worsened, but it is better than the industry average.
c) LMN's inventory turnover is improving, and it is better than the industry average.
d) LMN's inventory turnover is improving, but it is worse than the industry average.
Solution:

Step 1: Compute Cost of Goods Sold (COGS)

$$COGS = Sales - GrossProfit$$

Year 3 $2{,}500{,}000 - 1{,}000{,}000 = 1{,}500{,}000$

Year 4 $2{,}600{,}000 - 1{,}200{,}000 = 1{,}400{,}000$

Step 2: Compute Average Inventory

$$Average\ Inventory = \frac{Beginning + Ending}{2}$$

Year 3 $\frac{275{,}000+300{,}000}{2} = 287{,}500$

Year 4 $\frac{300{,}000+245{,}000}{2} = 272{,}500$

Step 3: Compute Inventory Turnover

$$Inventory\ Turnover = \frac{COGS}{Average\ Inventory}$$

Year 3 $\frac{1{,}500{,}000}{287{,}500} = 5.22\ times$

Year 4 $\frac{1{,}400{,}000}{272{,}500} = 5.14\ times$

Step 4: Analyze

- Year 3: **5.22**
- Year 4: **5.14**
- Industry average: **5.00**

Turnover **decreased slightly** from 5.22 to 5.14 → performance **worsened slightly.**

Compared to Industry

5.14 is still **above** 5.00 → better than industry.

b) LMN's inventory turnover has worsened, but it is better than the industry average.