

**Revisions to the
2009 Core Knowledge Exam Multiple Choice Questions Book and Supplement**

The changes to the following question have been **bolded**.

Book – Question 221 and Exam 7 – Question 26:

In auditing large multinational firms, the primary auditor may need to rely on a secondary auditor to audit a foreign subsidiary. Which one of the following statements about secondary auditors is **correct**?

- a. The primary auditor would normally engage a secondary auditor to perform specified limited procedures.
- b. The primary auditor may refer to the secondary auditor in the opinion on the financial statements of the primary auditor.**
- c. The secondary auditor will consider such factors as assets, revenues, and net income in determining the materiality of the foreign subsidiary to the overall financial statements.
- d. The most effective way to review a secondary auditor's work is for the primary auditor to obtain and review copies of the secondary auditor's working papers and supplement this review with discussion or correspondence with the secondary auditor.

The changes to the following solutions have been **underlined**.

Book – Solution 221 and Exam 7 – Solution 26:

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- b. The primary auditor may refer to the secondary auditor in the opinion on the financial statements of the primary auditor.**
- c. The secondary auditor will consider such factors as assets, revenues, and net income in determining the materiality of the foreign subsidiary to the overall financial statements.
- d. The most effective way to review a secondary auditor's work is for the primary auditor to obtain and review copies of the secondary auditor's working papers and supplement this review with discussion or correspondence with the secondary auditor.

Solution:

The correct response is b. Per CICA Handbook s.6930.22, the primary auditor should not refer to the secondary auditor in his or her report when expressing an opinion without reservation. However, the primary auditor may refer to his or her ability to rely on the secondary auditor in his or her report when expressing an opinion with reservation if the auditor believes that this disclosure will help to explain the reason for his or her reservation.

When the primary auditor requires another auditor to perform specified limited procedures, s.6930 does not apply per s.6930.02(a). In fact, the term "secondary auditor" is defined in s.6930.03(d) as an "auditor reporting on the financial statements of a component." Therefore, merely performing specified limited procedures does not meet this definition (response a).

According to s.6930.06, it is the primary auditor (and not the secondary auditor) who makes the determination of the materiality of the foreign subsidiary (response c).

Per s.6930.17, the secondary auditor's work may be most effectively reviewed by having the primary auditor meet the secondary auditor (in person) and review selected working papers (response d).

Exam 7 – Solutions:

9. Organic Greens Limited (OGL) is a franchisor that sells franchises for organic vegetarian food restaurants. On December 1, 2009, OGL signed a three-year contract with a new franchisee, Jack Richards, to open a new restaurant in downtown St. Catharines. The contract specified an initial franchise fee of \$100,000 to cover assistance with site selection, obtaining financing, advertising, and personnel training. The site was selected and initial financing was secured by December 20, 2009. Due to a shortage in the labour market over the holiday season, employees were hired on January 5, 2010 and the restaurant opened on January 31, 2010. Which one of the following amounts of revenue should OGL recognize in its December 31, 2009 year end financial statements with respect to the initial franchise fee?
- a. \$0
 - b. \$33,333
 - c. \$50,000
 - d. \$100,000

Solution:

The correct response is a. AcG-2, Franchise Fee Revenue, recommends that initial franchise fee revenue would ordinarily be recognized when all material conditions relating to the sale have been substantially performed by the franchisor. It also states that this is usually the point at which the franchisee commences operations. Since the staff training that OGL was required to perform did not occur until 2010, no revenue could be recognized in 2009. All required services were performed by the time the restaurant opened on January 31, 2010 and thus recognition of the full amount of revenue at that time is appropriate.

Response d is incorrect as it assumes that revenue was earned entirely in 2009. Response b is incorrect as it amortizes the initial franchise fee over the life of the franchise contract. Response c is incorrect as it assumes that 50% of the services were performed in 2010 and that revenue could be recognized based on the portion of services.